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The right plan for Iraq
To fill Iraq's security vacuum, America needs to fill the country's political vacuum … More on this week's lead article

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Politics this week

Sep 23rd 2004
From The Economist print edition

It's still war

Reuters

In a speech to the UN General Assembly, **George Bush** defended progress made in Iraq since the fall of Saddam Hussein and called on the international community to help destroy terrorist networks. John Kerry stepped up his attacks, saying that Mr Bush "misled, miscalculated and mismanaged" his Iraq policy.

See article

Meanwhile, **Iraq's** insurgency continued unabated, though Mr Bush and the country's interim prime minister, Iyad Allawi, on a visit to the United States, insisted that hopes for eventual peace and prosperity still outweighed fear of fragmentation and chaos.

See article

Among a string of recent atrocities in **Iraq**, terrorists thought to be led by Abu Musab al-Zarqawi, a Jordanian with proclaimed links to al-Qaeda, beheaded two kidnapped American contractors and threatened to kill a third man with them, a Briton, unless the Iraqi government released all women detainees. The British and Iraqi governments said they would not negotiate with terrorists.

Sudan's government decried a resolution passed by the UN Security Council that threatens sanctions against the country's oil trade unless it stops violence in its western region of Darfur and co-operates with a bigger monitoring force from the African Union.

Japan, Germany, Brazil and India launched a co-ordinated bid for **permanent membership** of an enlarged UN Security Council. At present only America, Russia, China, France and Britain have permanent seats.

America formally lifted sanctions imposed against **Libya** in 1986, allowing it to unfreeze some $1.3 billion held in American banks and to remove blocks on trade and investment. Most of that sum is earmarked to pay damages to the 259 victims in a Pan Am airliner blown up in 1988 over the Scottish town of Lockerbie. The European Union said it too would lift economic sanctions, including a ban on the sale of some arms.

See article

At the annual congress of **Egypt's** ruling National Democratic Party, modernisers linked to President Hosni Mubarak's son Gamal were promoted.

See article

After the storm

Reuters

More than 1,000 people were killed and another 1,000 were missing after a storm triggered flash floods and mudslides in **Haiti**. Deforestation means that the country's hillsides do not absorb rainwater.

See article

Argentina's government replaced Alfonso Prat-Gay, the head of the Central Bank. Mr Prat-Gay, an economist, was seen as market friendly; his replacement, Martín Redrado, the deputy foreign minister, is also an economist. The government is poised to launch a go-it-alone restructuring of defaulted debt totalling some $100 billion.

See article

The Bush administration backtracked from earlier claims that **Cuba** was making biological weapons. A new assessment, prepared for the State Department, expressed concern about Cuba's exports of biotechnology products that could be used for military as well as civilian purposes.

On the ticket

Florida's Supreme Court ruled that **Ralph Nader** will appear on the state's presidential election ballot. Democrats, who accuse Mr Nader of taking votes from them in closely fought contests, argued that his candidacy did not meet state requirements.

Porter Goss was confirmed by the Senate as the next head of the **CIA**. The Republican congressman from Florida promised bipartisanship in his future dealings with Congress.

Campaign-finance reports showed that Mr Bush raised a total of $260m for his re-election effort, shattering the $100m record he set in 2000; Mr Kerry raised about $235m. Both candidates are now restricted to public funding until election day. Meanwhile, a judge ruled that the Federal Election Commission's regulations did not go far enough in stopping politicians and political groups from co-ordinating over “soft money”.

Hurricane Ivan ended its trail of destruction by sparking tornadoes and severe storms in the southern United States and along the eastern seaboard. At least 45 people were killed, making it the deadliest hurricane to hit America since 1999.

A lurch to the right

Eastern German voters elected two far-right parties to the state parliaments of Brandenburg and Saxony respectively. Germany's ruling Social Democrats did badly, as usual; but so, this time, did the opposition Christian Democrats, casting new doubt on Angela Merkel's leadership.

See article

Turkey upset the European Union by dropping its proposed reforms to the penal code, and talking of reviving plans to criminalise adultery. The European Commission said that, if Turkey's penal code were not changed, it would not recommend a start to membership talks. But a compromise appeared to have been reached after the Turkish prime minister flew to Brussels.

See article

Nicolas Sarkozy, **France's** finance minister, surprised markets by saying he would cut the budget deficit to below 3% of GDP for 2005. The credit goes to a stronger economy, rather than spending cuts.

See article

Italy's maverick prime minister, Silvio Berlusconi, ruffled some feathers by saying that Fiat's chairman, Luca di Montezemolo, would make a good successor. He may or may not have been joking.

Easy victory?

Incomplete returns showed Susilo Bambang Yudhoyono trouncing Megawati Sukarnoputri in **Indonesia's** presidential election.

EPA

See article

Jiang Zemin resigned as chief of China's armed forces, turning over the last of his three posts to his chosen successor, Hu Jintao. Mr Hu is also president and general secretary of the Communist Party.

See article

Meetings between George Bush, **India's** prime minister, Manmohan Singh, and **Pakistan's** president, Pervez Musharraf, sparked hopes of progress on relations between the subcontinent's nuclear powers.

See article

Malaysia, Indonesia and the Philippines all dismissed an **Australian** plan to create regional anti-terrorist police squads. The Australian prime minister, John Howard, has riled his neighbours with talk of pre-emptive strikes against terrorist threats.

See article

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Business this week

Sep 23rd 2004
From The Economist print edition

Blowing smoke

America's biggest **tobacco companies** went on trial for deceiving the public over the dangers of smoking. The lawsuit was filed by the Clinton administration in 1999. The Bush administration was expected to drop the case, but instead had brought it to trial, and is seeking $280 billion from the cigarette-makers, who deny the charges.

See article

Computer Associates agreed to pay $225m to avoid prosecution by America's Department of Justice relating to a $2.2 billion accounting fraud at the company. But Sanjay Kumar, a former chief executive, and another former manager, were charged in connection with the “massive fraud”. CA accuse Mr Kumar of betraying the company.

In a foretaste of bigger trials to come, the first court cases began against two former middle-ranking **Enron** employees and four erstwhile Merrill Lynch executives. They are accused of disguising a loan to the energy trader as a sale of Nigerian energy-producing barges to Merrill, thereby bolstering artificially the energy trader's finances.

See article

An eight-month government investigation of **Fannie Mae** found evidence that the American mortgage lender had manipulated its accounts to smooth out revenues, in one case to meet executives' bonus targets. The Securities and Exchange Commission began an informal investigation.

Martha Stewart was granted her wish that she begin a jail sentence as soon as possible for lying about a share sale, though she could have remained free pending an appeal. The lifestyle guru will start her five-month stretch in October, timing her release for the spring gardening season.

Winds of change

Oil prices soared above $48 a barrel after data was released showing a fall in America's fuel stocks in the aftermath of Hurricane Ivan. Meanwhile, China's appetite for oil continued to grow; imports in August were 37% higher than a year ago.

See article

Royal Dutch/Shell unveiled plans to restore its fortunes in the wake of a scandal that forced the oil giant to cut its stated oil reserves by some 20%. Shell said that it would raise up to $12 billion through asset sales and that it would invest some $45 billion to boost production. Investors were unimpressed; the firm's shares drooped.

Unilever unexpectedly announced that profits for the year would amount to less than half its previous forecast. The Anglo-Dutch consumer-goods firm faces stiffer competition but also blamed poor weather in Europe for falling ice-cream and drink sales. Its shares fell by nearly 5%. **Colgate-Palmolive**, an American rival to Unilever, also felt the pinch. It issued its first profits warning for nine years.

See article

A week after attracting criticism for insisting that he would see out the remaining two years of his contract as chief executive of Disney, **Michael Eisner** said that he would not seek the chairman's job. This allayed fears that his continued presence at Disney would deter top candidates for the post.

PeopleSoft and **IBM** agreed to a $1 billion marketing alliance. The move fuelled rumours that the computer giant could emerge as a “white knight” to stymie Oracle's long-running $7.7 billion takeover bid for its smaller rival.

Money banks

Profits at **Goldman Sachs** rose unexpectedly sharply in the latest quarter to $879m, some 30% more than a year ago. Bond trading and investment banking reaped richer rewards than expected.

Lehman Brothers saw profits rise by 5% in the same period to $505m. But **Morgan Stanley** suffered a reversal of fortunes. Profits for the quarter fell to $837m, almost a third down on a year ago, as costs rose and its bond-trading arm struggled.

Bailing out

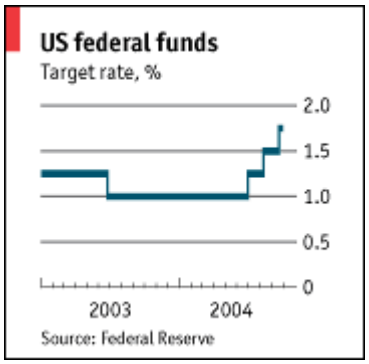
Alitalia's board approved a rescue plan for the stricken airline that sacrifices thousands of jobs in return for access to emergency funds. The EU welcomed the scheme but said that it would scrutinise the fine print to ensure that no state aid other than a *euro*400m ($490m) government-backed loan reached the airline.

Air New Zealand said that its future was in doubt after the country's High Court backed a decision by competition watchdogs that bars a tie-up with Australia's **Qantas**. The airlines had hoped to see off the threat from low-cost rivals together.

Going up

America's Federal Reserve raised **interest rates** for the third time this year, by a quarter point to 1.75%. Citing improvements to output and the labour market, the Fed hinted at further increases. But the yield on ten-year Treasury bonds fell below 4%.

See article



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America and Iraq

The right plan for Iraq

Sep 23rd 2004
From The Economist print edition

To fill Iraq's security vacuum, America needs to fill the country's political vacuum

NOT before time, the spotlight in America's election swivelled this week from a war that ended some 30 years ago in Indochina to the war raging right now in Iraq. But, as you might expect barely six weeks from polling day, neither George Bush nor John Kerry is giving a completely straight account to the American people.

In various speeches this week, Mr Bush claimed to believe that, provided America does not waver, it is well on the way to making Iraq a beacon of freedom and democracy for the Greater Middle East. This is an absurdly rosy forecast given the horrific violence that now grips so many parts of Iraq, including the capital. Mr Kerry may have been closer to the truth when he said in New York that Mr Bush's handling of the occupation had been so inept that America had traded a dictator for “a chaos” from which a new generation of terrorists could some day hit the United States. However, Mr Kerry purveys a false optimism of his own. He claims that a fresh approach under a new American president can turn the position around. This is a distortion. If a Kerry administration can turn the position around, it will not be because it has a new plan. For although Mr Kerry's diagnosis of what is wrong in Iraq is franker than Mr Bush's, his prescription is basically the same.

A good plan on paper

Mr Bush has chopped and changed his approach many times since the invasion. But the plan now in place makes perfect sense on paper, enjoys a fair amount of support inside Iraq and has been formally adopted by the UN Security Council. Under it, the UN-appointed interim government of Iyad Allawi is supposed to hold the ring until a UN-supervised election takes place next January. The government thus elected then has the job of drawing up a new constitution and holding a new election under its rules in early 2006. Mr Kerry does not question any of this, promising only to be more effective than Mr Bush in enabling it all to happen. But most of the enabling steps he proposes are things the present administration is already trying to do: beefing up Iraq's fledgling army and police force, rebuilding the economy and making sure that January's promised election will be credible. As for Mr Kerry's claim that once he is in the White House other nations will gallop to America's rescue in Iraq, this is whistling in the wind. If the violence continues at its present level it will be hard enough for any American president to stop the existing dwindling band of helpers from bolting, let alone persuade new ones to put soldiers and civilians in harm's way.

The future of Iraq does not now depend on coming up with some radical new blueprint. It depends on whether the present plan can withstand the violent attacks on it. And this, sad to say, remains far from certain. When at the end of June Mr Allawi's government formally inherited control from the American-led Coalition Provisional Authority, the hope was that a government of Iraqis would command greater legitimacy than a government of foreigners, and so suck much of the oxygen out of the anti-occupation “resistance”. In some ways, Mr Allawi has been a success. He has a robust—some say autocratic—style of leadership. He has genuinely taken over many of the decision-making powers previously exercised by the Americans through their now-departed proconsul, Paul Bremer. When American forces undertake big military operations, such as the recent siege around the Shia holy town of Najaf, it is he who calls many of the shots. But however much this change of guard may be welcomed by ordinary Iraqis, it has not improved security. If anything, the insurgency appears to have waxed ever stronger.

Right now, much of the swathe of central Iraq known as the Sunni triangle is slipping beyond the control of either the interim government or the largely American “multinational” force that supports it. The town of Fallujah, which American marines failed to wrest back in bitter fighting last April, has become a no-go area: from it, a miscellany of insurgents, ranging from secular local nationalists to foreign *jihadis*, mount increasingly horrific suicide bombings and kidnap raids on other cities, including Baghdad. But the insurgency is not confined only to the Sunnis, the minority that dominated the regime of Saddam Hussein. A large number of Shias, both in the south and in the poorer suburbs of Baghdad, have shown themselves willing to open fire on government and American forces alike if ordered to do so by Muqtada al-Sadr, the volatile young cleric who agreed last month to pull his militia out of the Imam Ali mosque in Najaf, but whose attitude towards the coming election remains a study in vagueness.

A bloody mess on the street

Can a “credible” Iraqi election be held in such circumstances? Or should the Americans mount a powerful pacification effort first? These are fine judgments. An election in which a large proportion of Sunnis, and perhaps some Shias, cannot or will not vote is certainly not going to produce an uncontested result. A government elected this way will certainly continue to face violent challenges. It would certainly be better in an ideal world if the country were at peace before going to the polls. The problem, on the far from ideal streets of Iraq, is that until a general election takes place, nobody will be seen to have the moral authority to impose the necessary peace.

The lesson of the occupation so far is that filling the political vacuum is part and parcel of filling the security vacuum. American forces have the raw power to smash their way into Fallujah tomorrow. But what then? Launching an offensive at the behest of a mere appointee such as Mr Allawi would be a far more dangerous undertaking than doing so on the orders of a government that will have been elected, however imperfectly, by millions of Iraqis. Indeed, such an election could be a transforming event. It will not bring tranquillity at a stroke: turning Iraq into the model democracy of Mr Bush's dreams is a job that will take years, if it is possible at all. But holding an election is the crucial first step if Iraq is to be saved from the war without end that Mr Kerry fears. All of America's efforts there should now be bent towards this aim.

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China

Hu done it

Sep 23rd 2004
From The Economist print edition

China's president has gathered all the levers of power into his hands

LAWS are like sausages, Bismarck once said: the less you know about how they are made, the better. The old Prussian would surely have approved of communist China, where the making of laws, like the forming of governments, is a procedure veiled in obscurity. The past week, though, has seen the production of a more than usually mysterious sausage. On September 19th, without the faintest hint of a warning, Hu Jintao, China's president and the general secretary of its Communist Party, acquired the third and final of the country's most powerful offices, taking over as head of the party's military commission—in effect, as commander-in-chief of the army. His predecessor, Jiang Zemin, had refused to surrender this last, and arguably most potent, of titles when the transition to Mr Hu began in 2002. Ever since, there have been rumours of discord—full-blown power struggles, in the view of some; mere factional differences, say others. But now Mr Hu is apparently in sole charge, and the era of Jiang Zemin is over.

Or is it? Deng Xiaoping continued to rule China as “paramount leader” for several years after he notionally retreated into semi- (and later full) retirement, a fact that was not known for some time, until accidentally revealed during the Tiananmen Square crisis of 1989. Of course, Mr Jiang is no Deng: but as many as five of the nine members of the Standing Committee of the Politburo are reckoned to be his creatures, so he may retain a residual influence on policy. Mr Hu is anyway a more constrained figure than Mr Jiang was, just as Mr Jiang's authority never matched Deng's, or Deng's that of Mao. The cult of personality in China has progressively given way to a more collective style of leadership. And it may be significant that Mr Hu has so far not been termed the “core” of that leadership by the official media, unlike his predecessors. But what this all boils down to is that the effect of the latest news is really anyone's guess. This opaqueness might not have mattered greatly when China was isolated from the world, and when its internal upheavals affected only the Chinese. But it is a regrettable anachronism today, now that China has become an engaged and influential member of the community of nations.

Still, some guesses can be made more confidently than others. China's economic reforms, for instance, are not in any real doubt. Integration with the outside world will continue and intensify, and the need to restrict lending so as to cool an unsustainable rate of economic expansion and avoid a crash seems to be generally recognised as well. Historians may well record that the greatest of Mr Jiang's achievements was to put the role of capitalism (“advanced productive forces”, as it is euphemistically known) beyond debate by enshrining it in the constitution of the Communist Party. If policy is to change at all, it may be in the direction of paying more attention to the victims of wrenching economic change: Mr Hu and his prime minister, Wen Jiabao, sometimes emphasise the need to make China's Dickensian version of capitalism more palatable. But the scope for doing much is strictly limited.

Continuity is also probable, though somewhat less so, in the conduct of foreign relations. Mr Jiang's other great achievement has been to accept America's pre-eminence in world affairs, and to abandon any hope of trying to challenge it by such doomed experiments as China's short-lived “strategic partnership” with Russia. Instead, China has worked hard to engage with America—this was Mr Jiang's forte, with his penchant for singing “Love Me Tender” and quoting the Gettysburg address—and also with its neighbours and the wider world. China has proved remarkably calm as America has gone about its war on terror, and has, if with only limited success, hosted three rounds of six-party talks aimed at defusing the crisis over North Korea's nuclear ambitions. It has become an enthusiastic participant in Asian economic and security forums, a member of the World Trade Organisation and a useful contributor to international peacekeeping operations. China, these days, is what some analysts call a “status quo power”, and as

such, less likely to engage in sudden policy shifts.

There is, however, one large question mark over the conduct of foreign policy, in the shape of China's attitude towards Taiwan. The next year or so could well prove a turbulent time. An election in December may give Taiwan's president, Chen Shui-bian, control of parliament, to go with the enhanced mandate he personally won in March. He would be likely to use that power to advance, at least incrementally, the cause of Taiwanese independence. What would China's reaction be? The one genuine policy difference between Mr Jiang and Mr Hu is sometimes said (one cannot, of course, be sure) to be over Taiwan—Mr Hu being alleged to favour a more cautious line than Mr Jiang's more hawkish one. Yet Mr Jiang himself was frequently accused by nationalists of being soft on Taiwan; and no imaginative thinking has yet emerged from Mr Hu on the subject. But imaginative thinking is sorely needed. Any kind of conflict in the Taiwan strait would hurl all of China's other relationships into chaos.

A chance, at least, to come out of the closet

Which leads, in increasing order of uncertainty, to political reform. It has frequently proved tempting to see Mr Hu as a Chinese Gorbachev, though the evidence for this has always been tenuous (see article). True, when he ran the Communist Party School, it pondered the possibility of limited democratic reform; but that school's job has always been to think radically, in a theoretical way at least. In the past two years, Mr Hu has proved disappointing as a reformist. China has crushed Hong Kong's hopes for democratic change, cracked down on contentious discussion on the internet, and shown little enthusiasm for allowing proper elections even to party posts, let alone national ones. There has been a bit more openness, particularly in the way the government admitted to its failings in handling the SARS respiratory disease, though even that was a position forced upon it, and has not been sustained. The overall record is poor. How far was this a result of Mr Jiang constraining Mr Hu? With Mr Hu secure in his position, might things start to change? All that can confidently be said is that if Mr Hu is indeed a reformist, he can now start to show it.

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Telecommunications

The march of the mobiles

Sep 23rd 2004
From The Economist print edition

Is there no limit to the potential market for mobile communications?

WHEN it comes to new designs for mobile phones, the model announced last week by a start-up based in Scottsdale, Arizona, really takes the biscuit. Shaped like a bone, it operates only as a speakerphone, picks up automatically when called, is mounted on a red strap for wearing around the neck, and is labelled with a large paw—because the PetsCell, as it is called, is a mobile phone for dogs. PetsMobility, the firm behind this astounding device, boasts of “Connecting every member of your family—even your pet”.

This is not quite as ridiculous as it sounds. Indeed, you can expect more examples of this kind of thing in the coming years. The reason is that the mobile-telecoms industry has become a victim of its own success. With sales of 600m units a year, mobile phones are simultaneously the world's most widespread communications devices, computing devices and consumer-electronics products. Almost everybody in the developed world now has one, and growth is booming in the developing world too. China is the world's largest market for mobile phones, and Africa is the fastest-growing. In the least developed parts of the world, entrepreneurs such as Bangladesh's “telephone ladies” rent out mobiles by the minute, putting phones into the hands of even the poorest. The oft-quoted statistic that two-thirds of the world's population has never made a phone call is no longer true.

As a result, the industry is frantically looking for new sources of growth, since it will not be able to rely on subscriber growth for much longer. And in the developed world, it cannot rely on subscriber growth even now. Hence the logic of selling phones for dogs. Another untapped market is phones for infants: Communic8, a British firm, has launched the MyMo, a simple phone aimed at four-to-eight-year-olds, while SK Telecom in South Korea offers a similar device, i-Kids, with built-in satellite tracking. And even when every human, cat and dog has a phone, there are always cars, laptop computers, household appliances and industrial machinery. Install a phone and some sensors inside a bulldozer, and it can call a mechanic before it goes wrong. DoCoMo, Japan's leading mobile operator, estimates that the potential market for mobile phones in Japan is at least five times the number of people.

Another approach is to encourage people to use their existing phones more than they do at the moment. Third-generation networks, which will offer lots of extra capacity, will lead to lower prices and, the industry hopes, more phone calls. Similarly, there is much excitement about “fixed-mobile convergence” (see article), a technology that allows people to use their mobile handsets to make cheap calls at home over fixed-line networks—again, it is hoped, boosting usage. Extending mobile coverage, so that subscribers can make calls wherever they are, is another tactic. Coverage is already available in underground railway networks in many cities, and within two years it will be extended into what is many people's last remaining phone-free environment: aeroplanes.

When everyone on earth is on the phone all day long—calling their dogs, cars or washing machines, if not each other—will the market finally be saturated? No. Plans are already afoot to stream music, video and other downloads to mobile phones in the dead of night, when networks are almost empty. Even being asleep, it seems, need not prevent you from using your phone. Evidently the industry has far to go before it reaches the limits of mankind's desire to communicate.

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German elections

A plague on both your parties

Sep 23rd 2004
From The Economist print edition

Gloomy voters reach out of the political mainstream

AFP

IN MOST elections, a bad result for the governing party means a good result for the opposition, and vice versa. Not in last weekend's polls in Brandenburg and Saxony, two big eastern German states. As has become normal these days, Chancellor Gerhard Schröder's Social Democrats (SPD) did badly—their share of the vote in Saxony was the lowest the party has scored in any state since 1945. But the opposition Christian Democrats (CDU) did even worse. The big gainers were the ex-communist PDSand the two extreme-right parties, both of which swept past the 5% threshold for seats.

Given German history, it is naturally the performance of the far right that has drawn the most attention. The neo-Nazi NPD will now sit in a state parliament (Saxony's) for the first time in 36 years. Yet hysterical comparisons with Weimar are overblown. The far right has surged before, only to fall back in later elections. Moreover, eastern Germany is in an especially deep hole, with unemployment close to 20% (over twice the western rate). The whole region remains dependent on federal handouts from the west to maintain living standards.

The right way to interpret these elections is more as a protest, akin in many ways to the street demonstrations that are taking place every Monday against the government's welfare cuts and labour-market reforms, due to come into effect next January. It is a pattern that has previously been seen across central Europe: voters disappointed when extravagant promises made after the collapse of communism were not fulfilled have often turned towards ex-communist parties and the far right. Fifteen years after the fall of the Berlin Wall, eastern Germans are reacting similarly to the failure to create the “flourishing landscapes” that Chancellor Helmut Kohl promised them in 1990.

The SPD has lost support across the whole country, chiefly because the Schröder government has failed to revive the sickly German economy. The government's Agenda 2010 package of economic reforms remains unpopular. Until last weekend the CDU had generally benefited from Mr Schröder's discomfort, especially in western Germany. But in the east at least, it is no longer doing so. That may be because it is the party of Mr Kohl, who promised *Ossis* so much, but delivered so little. But it may also be because the CDU is promising to make even more reforms than the government.

Reform, reform

Indeed, an inevitable reaction to these results will be to lay the blame on reforms. Left-wingers in the SPD have been calling for Mr Schröder to abandon Agenda 2010—and threatening to start a new breakaway party if he does not. Within the CDU, there are growing demands that the party leader, Angela Merkel, distance herself from economic reforms, instead of promising to be more radical still.

Yet it would be a political, as much as an economic, mistake to slow down or abandon the process of reform in Germany. For a start, there is evidence that the reforms are working. Health-care costs have begun to come down; the labour market seems to be slowly improving; over the past two quarters the economy has also perked up a little, albeit more slowly than elsewhere in Europe. Indeed, this would be a good moment for Germany to bring in further reforms, not to slow down what it is already doing. The chief reason why eastern Germany, unlike neighbouring Poland, remains a basket-case, is that unification

in 1990 imposed on it western Germany's generous welfare system and highly regulated labour market. If the economy is to regain its competitive edge, both parts of Germany must do a lot more to deregulate labour markets and cut costs.

In any case, these elections suggest that it is possible to persuade voters of the benefits of reform. The SPD did slightly better than had been expected in Brandenburg, where it remains the largest party ahead of the PDS. Yet Matthias Platzeck, its premier, vigorously defended Agenda 2010 during the election campaign. In neighbouring Saxony, by contrast, the CDU premier, Georg Milbradt, flirted with an anti-reform line—yet his party shed 16 points in the polls, and he is now in search of a coalition partner. This suggests that what German economic reforms now require is more skilful political salesmanship, not to be thrown out of the window.

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Oil-exporting countries

Tackling the oil curse

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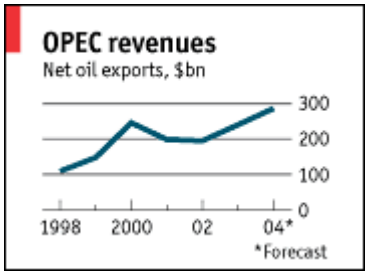
From The Economist print edition

Petroleum producers cannot afford to squander the windfall from the current oil boom



"I CALL petroleum the devil's excrement. It brings trouble...Look at this *locura*—waste, corruption, consumption, our public services falling apart. And debt, debt we shall have for years." Those powerful words were uttered by Juan Pablo Pérez Alfonso, a Venezuelan founder of the Organisation of Petroleum Exporting Countries (OPEC), during the heady oil boom of the mid-1970s. At the time, he was seen as an alarmist.

In fact, he was astonishingly prescient. Oil producers vastly expanded domestic spending, mostly on gold-plated infrastructure projects that set inflation roaring and left mountains of debt. Worse, this did little for the poor. Venezuela has earned over $600 billion in oil revenues since the mid-1970s, but the real income per person of Mr Pérez's compatriots fell by 15% in the decade after he expressed his disgust. The picture is similar in many OPEC countries. So bloated were their budgets that when oil prices fell to around $10 a barrel in 1998, a number of countries—including even Saudi Arabia, the kingpin of oil—were pushed to the brink of bankruptcy.

Oil prices rebounded, of course, and so they were saved. After several years of strong prices, including a recent high of about $50 a barrel, OPEC is once again rolling in money. The cartel's revenues may exceed $300 billion this year, up from around $120 billion in 1998. However long it lasts, will this windfall once again be squandered?

Perhaps, but there are signs that oil producers are trying to act more wisely than in the past (see article). To do so, however, they will need to consider three difficult measures: parking oil money offshore, opening government accounts to scrutiny and reforming subsidy-addicted economies.

A northern star lights the way

Investing much of their windfall offshore could help oil exporters to avoid a sharp rise in their currencies and the overheating of local economies (the so-called "Dutch Disease"). One promising, though not perfect, way to do this is to set up an offshore fund specifically for a portion of the windfall. This not only avoids currency appreciation, but also serves as a public reminder that oil is a non-renewable source of income that should not be consumed by one generation alone.

A number of oil producers, from Azerbaijan to Mexico, have set up such funds in recent years. In doing so, they have tried to emulate Norway, which has a well-managed "fund for the future". Alas, some of these governments have then quietly raided these funds to fill holes in their annual budgets—as Iran has done recently. Others have saved money in such funds even as they have piled up huge foreign debts. Only if there are checks on the executive's power, such as through independent audits and supervisory boards, will these off-shore funds be more than window dressing.

That points to the second prescription: transparency. Far too often, ruling elites have used oil revenues as personal slush funds. Nigeria is a notorious example of such corruption, but not a unique one. Happily, thanks to pressure from a curious coalition of human-rights groups, the financier George Soros, the British government and the IMF, oil economies are finally beginning to open up their books. The Extractive Industries Transparency Initiative is a voluntary scheme that encourages oil companies to publish what they pay, and governments to publish what they receive. It has recently persuaded a handful of countries, from São Tomé to Nigeria, to allow greater public scrutiny of government accounts.

The final, and hardest, measure is economic reform. Oil economies must get spending under control. In Saudi Arabia, the cost of producing oil is $2 a barrel—but balancing the government's books requires an oil price of perhaps $25 a barrel. Even more important is to diversify. This will not be easy, but it can be done. Mexico, which embraced liberal economic reforms with gusto two decades ago, has managed to reduce oil's share of its national output to less than one-tenth.

Could this really happen in a petro-state like Saudi Arabia, which looks likely to earn a whopping $100 billion from oil this year? Not for ages, but there are positive signs. The Saudi rulers have opened up some sectors, such as utilities and petro-chemicals, to foreign and private investors. They are encouraging diversification, and say they are keen to join the World Trade Organisation. To understand how rocky the road ahead might be, though, consider one big obstacle to Saudi Arabia's WTO membership: the huge subsidies paid to powerful families growing wheat in the Saudi desert. Only when such grotesque abuses end will oil wealth stop being cursed as diabolical and start being seen for what it should have been all along—a blessing.

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Reviving Japan's economy

There's no place like home

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A new era is within Japan's reach, if Junichiro Koizumi seizes the chance

AFP

CHARITY may begin at home, but Japan's intermittent economic recoveries always start somewhere else. Its latest is no different. Booming demand for exports has powered an impressive rebound over the past couple of years. This time, however, growth is also spreading to the domestic economy. Japan is in its best position since 1989, when a financial crisis plunged its economy into a despond of repeated recessions and slow growth. It now has a real chance of building a lasting recovery of its own, one not overly reliant on exports but supported by domestic growth as well. To achieve that, however, it must overhaul its decrepit service sector. Much of that chore falls to Junichiro Koizumi, the prime minister, who will revamp his cabinet next week.

Mr Koizumi's critics, the fiercest of whom are in his own Liberal Democratic Party, are calling more loudly than ever for him to ease up on reform. They have been emboldened by the party's poor showing in upper-house elections this summer. Mr Koizumi anyway has at most two years left as prime minister, because his party's rules require him to step down in September 2006. His critics are hoping that he will now become a lame duck. Instead, Mr Koizumi must send a clear signal with next week's reshuffle that he intends to use the rest of his term to carry out the structural reforms that he has promised.

Japan desperately needs these. Its world-beating manufacturers can no longer, by themselves, power the long-term productivity growth that the country requires to cope with the burden of a rapidly ageing population and stiffer competition from across Asia. As in other rich economies, Japan's service sector, which has always been largely sleepy and uncompetitive, must start to pull more of its potential weight. That transition should have begun in the 1990s, but Japan's misguided response to its banking crisis kept many insolvent firms alive, distorting competition and holding down productivity in retailing, wholesale distribution, construction, utilities and a variety of other service industries (see article).

Admittedly, the signs have grown more encouraging lately. This time, the export-led recovery has boosted profits throughout the economy, making it easier to separate winners from losers among service companies. On Mr Koizumi's watch, regulators have pressed the banks, at least the biggest ones, to abandon their remaining deadbeat borrowers. Rising profits and shrinking debts might finally defeat Japan's long bout of price deflation, which has so damaged prospects for growth.

Mr Koizumi can hardly afford to let up, however. The risk remains that marginal borrowers will slide back into trouble, either because export growth slows sharply or because rising demand pulls up interest rates. More importantly, Japan will not achieve decent long-term growth unless it boosts productivity in services. Mr Koizumi should choose a team that will press on, and make his priorities clear.

Post-structural reforms

He has already placed privatisation of Japan's huge postal system, which doubles as a giant bank and badly distorts the financial system, at the top of his list. But he must fight in parliament to ensure that this is done quickly and properly. Japan Post's banking and insurance arms should be separated from each other, as well as from the postal distribution network, and then regulated on the same terms as private competitors.

Financial reform should not stop there. Although the biggest banks have improved, many of Japan's regional banks remain saddled with dodgy borrowers and bad business models. The government needs to recapitalise some of them and merge or shut down others. Mr Koizumi should also prod the regulators to ensure that banks reduce bad loans through real restructuring rather than rosy assessments.

Beyond making capital flow where it is needed, Mr Koizumi must foster competition wherever he can. Instead of coddling small firms with tax breaks and subsidies, the government needs to get out of the way and let nimbler firms emerge. Mr Koizumi could also expand one of his best initiatives: letting local areas form special zones that are exempt from stifling national regulations. Why not make all of Japan a deregulation zone? Given the huge benefits that freer global competition has delivered to its now-mighty exporters, Japan would do well to try more competition at home as well.

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Letters

Sep 23rd 2004
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Dealing with terrorists

SIR – The only people guilty of the tragedy in Beslan are the blood-thirsty terrorists. ("Russia's horror", September 11th). The moment one tries to explain their motives or their cause one ends up legitimising the horror. They should be condemned in the harshest possible terms. They have no place in civilised society, regardless of their cause.

Jacob Amir
Jerusalem

SIR – You say that Russia should begin negotiating with Chechens on the political future of the republic, including "extreme autonomy, possibly leading to properly negotiated independence". One cannot condemn a terrorist attack and then consider acceding to the terrorists' ultimate demand. President Vladimir Putin speaks for civilisation as we know it when he refuses to bargain with those who kill children at school.

Jovan Ivosevic
Los Angeles

SIR – Despite your continued objective analysis of Russia's manipulation of the global war on terrorism few people see that through starvation, repression or elimination the Russian leadership is continually engaged in autocratic oppression of both its own people and neighbouring countries. It does not believe in nor acknowledge the right of self-determination of others, focusing instead on justification of its need to control other nations. Russia wants Chechnya's oil and fears the possibility of a NATO presence if Chechnya gains its hard-fought freedom.

This arrogance is dangerous, precludes discussion and can only lead to another war. It is unfortunate that Mr Putin still has the support of other world leaders, who seem either ignorant or unaware that Russia's tradition of controlling the strategic resources of its border nations has not changed since imperial times.

Christine Durbak
New York

Violating women's rights

SIR – You incorrectly simplify the situation in China that resulted in a de-funding of the UN Population Fund by the Bush administration ("Ten years' hard labour", September 4th). You suggest that the administration acted out of ideology or political expediency, rather than in accordance with American human-rights laws. A recently released State Department report shows that the Bush administration had actively engaged with the UNFPA in order to make its programme consistent with human-rights law and that the UNFPA had declined to adopt the American recommendations.

The report says that the UNFPA has not even asked that China "eliminate coercive 'administrative' or 'disciplinary' punishments" against women. These are the same punishments that a British parliamentary team found in 2002 but was confident that the UNFPA would eliminate. Two years later, they are still in place and the UNFPA has not demanded their removal. Women who become pregnant in contravention of

Chinese law are fined heavily unless they abort their unborn children. Why is such a gross violation of women's rights not worthy of a mention in your newspaper?

Douglas Sylva
Catholic Family and Human-Rights Institute
New York

A peace missing

SIR – You suggest prematurely that peace has finally come to Angola and that the once-Marxist MPLA government is now focusing its efforts on reconciliation with its enemies ("The long slow walk to normality", September 4th). While reconciliation may be happening on the Angolan mainland, one can hardly say with confidence that the same spirit exists when it comes to the oil-rich territory of Cabinda. The Angolan government is still waging a piecemeal genocidal war in the occupied territory of Cabinda. And yet there seems no willingness on the part of the MPLA government to engage in peace talks with the Front for the Liberation of the Enclave of Cabinda (FLEC). If Angola is to achieve real peace, the government must address the issue of Cabinda as part of the reconciliation process.

Babatunde Taiwo
Diplomatic Counsel
FLEC
London

Pact off

SIR – Your contention that peer pressure may succeed in making Europe's "stability and growth pact" work where the original pact did not is over-optimistic and already flies in the face of the statistical evidence ("The instability and fudge pact", September 11th). The pact was designed to limit the degree of fiscal looseness, or indiscipline, in the euro zone. All 12 participants committed themselves to the pact but it was set aside by France and Germany as soon as they exceeded the deficit limit of 3% of GDP, on the technically correct but spiritually corrupt grounds that the Council of Ministers—which includes France and Germany—had agreed that the pact's provisions did not need to be invoked in this case.

It is not clear how you could ever expect peer pressure to work in a system in which sinners sit in judgment on sinners (including themselves). And if potential sinners can behave like that, then why would the financial markets impose discipline? I fear that your article's title is only too accurate.

Andrew Hughes Hallett
Vanderbilt University
Nashville

Lost in translation

SIR – Charlemagne's observations on Britspeak for the Dutch left me wondering whether he grasped the full complications (September 4th). "I hear what you say" certainly can mean "I disagree and I do not want to discuss it any further." Just as often it can mean "I think you're right (on the facts or principles) but I'm going to overrule you for political reasons, so there's no point in discussing it further." "I'll bear it in mind" undoubtedly has the primary meaning "I'll do nothing about it" but fairly often also means "I hadn't realised you felt that strongly about it, and, while I'll do nothing about it for now, I already realise I may well have to backtrack in 12 months."

I particularly like "X has a bit of an attitude" meaning "X completely distrusts us, and is trying very hard to hang us out to dry." Or, as it would more likely be phrased, "X is being unhelpful", which would lead into the rich semiology of "X has been very helpful/quite helpful/not particularly helpful/not very helpful at all." Since the exact nuance here depends on the entire history of the speaker and X, it can be baffling even for a native Anglophone. But perhaps Eurocrats do not need a lexicon for this sort of thing.

G.M. Hurley
London

SIR – Charlemagne misses a vital element of continental practice. The Englishman will purse his lips, raise an eyebrow and furrow his brow but on the other side of the Channel the whole body is involved.

Without this, Silvio Berlusconi's remarks are incomprehensible. I have no difficulty, in France, with *jusqu'à un certain point* when accompanied by the open palms, the exaggerated shrug and rueful grimace. Unfortunately these aids are denied to our brave European Union translators.

Douglas Finney
London

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Indonesia's election

Enter a new star

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From The Economist print edition

AP

Indonesia's new president is wildly popular. But what can he do for the world's biggest Muslim country?

IN A poll last December, only 5% of potential voters named Susilo Bambang Yudhoyono as their candidate of choice in Indonesia's first direct presidential election. Yet he won the first round of voting, in July, with 34% of the vote, seven points ahead of the incumbent, Megawati Sukarnoputri. In the run-off, on September 20th, he widened his lead yet further, according to preliminary results, winning 61% to Miss Megawati's 39%. Although the final tally will not be known until October 5th, Mr Yudhoyono has all but claimed victory.

“SBY”, as the former general and minister is universally known (see article), is popular throughout the country. He appears to have beaten Miss Megawati in all but two of Indonesia's 32 provinces, even though she had a stronger political machine, more money to spend, and all the advantages of incumbency. He even gave Miss Megawati a run for her money in Bali, supposedly her stronghold. At one polling station in the small town of Ubud, election workers counting the ballots in their best batik sashes and headbands called out his name almost as often as hers.

Yet most Indonesians still know little about Mr Yudhoyono. His appeal seems to stem from his status as a relative outsider, his prominent role in Miss Megawati's government notwithstanding. In legislative elections in April, voters deserted the established parties in favour of new outfits, such as Mr Yudhoyono's Democrat Party. But his popularity began to soar only when he resigned from the cabinet in March to protest against the high-handed behaviour of Miss Megawati's unpopular husband, Taufik Kiemas.

While Miss Megawati—the daughter of Indonesia's founding father, Sukarno—grew up in the presidential palace, Mr Yudhoyono's childhood was spent in Pacitan, a town in eastern Java, where his father served as an army lieutenant. Miss Megawati now resides among ambassadors and tycoons in a leafy downtown district of Jakarta. Mr Yudhoyono lives in Cikeas, a dusty middle-class suburb an hour's drive from the city centre. He has declared his net worth as 4.5 billion rupiah ($500,000), compared with Miss Megawati's 75 billion rupiah. All this goes down well in a country where the elite tend to enrich themselves at their compatriots' expense.

According to the pollsters, Indonesians also like Mr Yudhoyono's military background. During his time in

the army—including two stints training in America—he was known as a mild reformer, who supported a ban on soldiers doubling as civil servants, for example. He took some bold stands as a minister, too, admitting that Indonesia had home-grown terrorists when many of his colleagues denied it, and pushing for talks with separatists in Aceh province when most politicians were clamouring for war. As a candidate he paid a pointed visit to *Tempo*, a crusading magazine battling multiple lawsuits, to underline the importance of a free press.

Crucially, while Miss Megawati shrank from public appearances, Mr Yudhoyono, as her co-ordinating minister for security, served as the government's most prominent spokesman. It was he who appeared on television to explain the government's efforts to restore order in restive provinces like Aceh, or to reassure the public after each new terrorist attack. His serious and meticulous bearing apparently charms Indonesian women in particular. At any rate, he is far more approachable and self-confident than Miss Megawati. When waylaid in a corridor by your correspondent with a question about the economy, he answered without hesitation in fluent English.

Indeed, Mr Yudhoyono has a reputation as an intellectual. During the final stages of the election campaign, he found time to defend his doctoral thesis at Bogor Agricultural Institute, one of Indonesia's grander universities. With the help of a laptop and a PowerPoint presentation, he argued that more efficient farming policies could help reduce rural unemployment. Earlier in the year, he invited a group of pundits and politicians to watch a documentary comparing the views of John Maynard Keynes and Friedrich Hayek on the role of the state in the economy. Members of the Democrat Party speak with awe of the huge library he has amassed. (Miss Megawati, by contrast, is said to have a taste for cartoons.)

An ear for everyone

If anything, Mr Yudhoyono is curious to a fault. He appears to listen to everyone, no matter how divergent their views. On the economy, he consults both free-marketeers and champions of state intervention. One of his most prominent advisers is Lin Che Wei, an Indonesian of Chinese origin who argues passionately against affirmative action for indigenous businessmen. But Jusuf Kalla, Mr Yudhoyono's running-mate, recently advocated the opposite approach. Likewise, on matters of religion, Mr Yudhoyono consults both Ulil Abshar-Abdalla, the founder of a group called the Liberal Islam Network, and Yusril Mahendra, the leader of a reactionary Muslim party. Both Christians and Muslims have accused him of a secret bias towards the other religion.

Mr Yudhoyono does not even seem to have a single campaign team. Cadres of the Democrat Party, former members of his ministerial staff, pals from his military days and assorted other politicians and businessmen all compete for his attention. No wonder, then, that he appears indecisive. He hesitated long and publicly before resigning from the cabinet, for example. Close aides express exasperation at how long he takes to make up his mind.

When he does make his views clear, Mr Yudhoyono often adopts cautious, middle-of-the-road positions. After watching the documentary on Hayek and Keynes, he announced that his beliefs lay somewhere between the two. He wants to spend more on education, but has not announced any money-raising measures to pay for it apart from cutting waste.

He also shies away from the boldest military reforms. He will not countenance the dismantling of the “territorial system”, whereby soldiers are stationed in every village like an army of occupation. Instead, he argues that these garrisons must not be allowed to indulge in smuggling, illegal logging and other shady money-making schemes. Rather than calling for the army to get out of business altogether, he says it must make its commercial activities more transparent.

Even in the fight against terrorism, Mr Yudhoyono eschews the most aggressive tactics. When addressing Indonesian audiences about the government's counter-terrorism efforts, he never uses the name Jemaah Islamiah to refer to the group that both local authorities and foreign governments blame for the country's bloodiest bombings. That suggests a reluctance to dispute the widely held view that America and Singapore, among other meddling foreign regimes, are exploiting terrorist attacks in Indonesia to pursue a witch-hunt against innocent Muslim clerics. By extension, a Yudhoyono government is unlikely to

challenge the popular sentiment that radical Islamic boarding schools cannot be held responsible for the misdeeds of a few of their graduates. So calls for Indonesia to shut down the handful of schools accused of funnelling recruits to Jemaah Islamiah will probably go unheeded. In general, Mr Yudhoyono, like most Indonesian politicians, seems least sure of himself when trying to draw a line between extreme piety and plain extremism.

Parliamentary complexities

In other words, Mr Yudhoyono is a leader in a classic Indonesian mould: cautious, consensual and deliberate. He obviously understands and broadly supports the tumultuous *reformasi* movement, which has transformed Indonesia from a near-dictatorship to a lively democracy in just six years. He doubtless grasps that he will suffer the same fate as Miss Megawati if he has nothing to show at the end of his five-year term. But he has no desire to subject Indonesia to further upheaval.

Nonetheless, Mr Yudhoyono may face more upheaval, whether he likes it or not. For one thing, he does not yet command a majority in the lower house of parliament (DPR). The Democrat Party holds just 56 of 550 seats. Even when the members of other, smaller parties that formally endorsed Mr Yudhoyono are added in, he can barely muster 20% support. The larger National Awakening and National Mandate parties may also back him. But the two biggest parties in the house, which together control a majority of seats, have sworn to remain in opposition. Theoretically, this alliance between Miss Megawati's Indonesian Democratic Party of Struggle (PDI-P), and Golkar, the former political vehicle of Suharto, Indonesia's strongman for 30 years, could stymie all Mr Yudhoyono's initiatives.

However, Indonesia's parliamentarians are a fickle lot. Mr Yudhoyono's advisers hope that his personal electoral mandate will cow recalcitrant legislators. If that fails, they say he should be able to cut deals and forge ad hoc coalitions on any given vote. Several Golkar MPs already openly back Mr Yudhoyono. They would like to depose the party's current leader, Akbar Tandjung, who championed its ill-advised alliance with Miss Megawati, and enlist Golkar in the new government. After her defeat Miss Megawati might also step down, leaving her party rudderless. All this manoeuvring may eventually provide Mr Yudhoyono with a chance to engineer a working majority—but it will also consume the DPR for months to come.

Reuters

Still feeling insecure

Nor is the DPR the only institution in flux. The upper house of parliament, called the Chamber of the Regional Representatives, or DPD, is assembling for the first time. The constitution gives it little say in legislation, except where regional issues are concerned. But no one yet knows how this vague demarcation will work in practice. Direct elections for provincial governors and regents, who head a lower level of administration, begin next year—further complicating the already pugnacious relationship between central and local government.

The new Constitutional Court has just begun flexing its muscles, with a ruling that the government cannot apply counter-terrorism laws retroactively. That decision threw the state prosecutors' entire strategy against suspected terrorists from Jemaah Islamiah into doubt. Meanwhile, the impact of new independent agencies, such as the Corruption Eradication Commission and the Judicial Appointments Commission, remains unclear.

All these reforms were designed specifically to diminish the powers of the president. After decades of authoritarian rule under Messrs Sukarno and Suharto, the legislators who enacted them were hoping to prevent the emergence of a new strongman. But such checks and balances will presumably hamper democratic leaders too. At any rate, they will take some time to get used to—time that Mr Yudhoyono cannot really spare.

The most pressing problem is the economy. When Miss Megawati came to office three years ago, Indonesia was still suffering from the fall-out of the Asian economic crisis of 1997. Growth was anaemic; the budget deficit and public debt were ballooning; the rupiah was unstable, and inflation and interest rates were rising. Against the odds, Miss Megawati's economic team has managed to restore macro-economic stability. Under the tutelage of the IMF, they have slashed the deficit, mainly by reducing subsidies and selling the banks and associated assets that the government had taken over during the

crisis. The subsequent appreciation of the rupiah has helped to reduce Indonesia's stock of public debt from over 90% of GDP in 2001 to roughly 60% today. Interest rates, in line with the global trend, have fallen steadily. All this propelled the economy to respectable growth of almost 5% (see chart).

Strangled growth

But the situation is not as rosy as these figures imply. The deficit is on the rise again, fuelled by Indonesia's ruinously generous oil subsidies. The government budgeted 14.5 trillion rupiah to pay for them this year, but, thanks to the high oil price, will probably end up shelling out four times as much. Pertamina, the state-owned firm that administers the subsidy, is facing a desperate cash crunch, and has resorted to running down its stocks.

Miss Megawati tried to raise fuel prices at the beginning of the year, but backed down in the face of widespread protests. Mr Yudhoyono now faces the unwelcome choice of raising fuel prices early in his tenure, or undermining the government's hard-won reputation for fiscal prudence. Worse yet, interest rates are now on the rise worldwide, so Indonesia is likely to face higher financing costs for the public debt. Miss Megawati's administration has already sold most of the government's holdings in listed firms, leaving Mr Yudhoyono with no easy way to raise a quick buck. There is little room for manoeuvre on the expenditure side, what with mandatory interest payments, transfers to the regions and salaries for civil servants.

In the longer term, Mr Yudhoyono must increase the rate of growth if the economy is to provide jobs for the millions of young Indonesians who enter the workforce each year. As it is, unemployment has crept up to 9.2%, a higher level than at any point during the economic crisis (see chart). Economists reckon that Indonesia must grow by at least 7% just to keep the ranks of the jobless in check.

The chief obstacle to higher growth, Mr Yudhoyono told *The Economist*, is Indonesia's dismal business climate. Obstreperous unions push up labour costs and reduce productivity. Overlapping jurisdiction between the central government and local authorities has created a regulatory muddle. Banks, scarred by the crisis, are reluctant to lend. Foreign direct investment, unsurprisingly enough, has slowed to a trickle, while the capital flight that has afflicted the country since the crisis continues. Mr Yudhoyono has pledged to address all these problems, but none of them is susceptible to a quick fix.

Terrorism, too, will continue to plague Indonesia. After a slow start, the authorities are now doggedly pursuing the remaining members of Jemaah Islamiah, even if they do not call them that. Despite the government's best efforts, however, a suicide bomber managed to kill himself and nine bystanders outside the Australian embassy in Jakarta earlier this month. Jemaah Islamiah's chief bomb-makers remain at large, and there seems to be no shortage of volunteers to disseminate their handiwork. Miss Megawati's government is already co-operating with foreign intelligence agencies to track the perpetrators down. It is hard to see how Mr Yudhoyono can accelerate this painstaking work.

In fact, the plodding pursuit of incremental improvements in security and the economy may well become the hallmark of Mr Yudhoyono's presidency. After all, the many new laws and constitutional amendments of the past six years have already put a rough policy blueprint in place. All Mr Yudhoyono needs to do is implement it. He may not be the most flamboyant of reformers—but he may yet prove the right man for

the job.

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Etiquette

What's in a name?

Sep 23rd 2004
From The Economist print edition

The trouble with Susilo Bambang Yudhoyono

TO EVERYONE in Indonesia, he is simply “SBY”—pronounced something like “ess-bay-yay”. But Susilo Bambang Yudhoyono is unusual among Indonesians in having such a batch of names. Many Javanese—think of Sukarno and Suharto, not to mention Wiranto and Budiono—use only one, and that is often abbreviated. Suharto was generally known as Pak Harto, Pak being a title of respect somewhere between “Mr” and “father” and itself short for “Bapak”. Sukarno was often called Bung Karno, where Bung was much more familiar, meaning “elder brother”. So which of SBY's names ought one to use? None of them is really a family name, since Javanese seldom use them. SBY's children bear the name Yudhoyono, but neither of his parents does.

Indonesia's press has been unhelpful on the issue. Some papers (when not calling him plain SBY) have called him Mr Susilo, some Mr Yudhoyono. Some have even preferred to go with Bambang—which is probably over-familiar, since it is what his close friends call him. *The Economist* has, up until now, called him Mr Susilo. But now that he has abruptly become a figure of global significance, we accept—if only to avoid confusion—that we should fall into line with what has recently become standard usage in the international press, even if in Indonesia itself things are rather more complex. And so we congratulate Mr Yudhoyono on what appears to have been a thumping election victory.

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Dealing with Iraq

Searching for an answer

Sep 23rd 2004 | WASHINGTON, DC
From The Economist print edition

AP

This week, Iraq produced some of its most traumatic recent news for America. It also changed the election campaign

Get article background

THROUGHOUT this year Americans have continued to die in Iraq. Yet in the election campaign, Iraq has been a pervasive but not a defining issue. The most openly anti-war Democrat—Howard Dean—flamed out in the primaries. Since then, George Bush and John Kerry have wrangled over some details of the combat but the campaign has recently spent far more time on a phoney argument over Swift boats, Vietnam medals and Alabama National Guard records.

The main reason for this is that Mr Kerry has been all over the place on Iraq: you could barely tell why he voted for the war or what he would have done differently. A secondary factor has been the bipartisan agreement at the start. Most Democratic senators, including Mr Kerry and John Edwards, voted to give Mr Bush “all necessary means” to remove Saddam.

This week, that changed. In a dramatic speech at New York University, Mr Kerry sought to clarify his previous muddle and break with the frayed bipartisan consensus. Mr Kerry's speech was given urgency by a fresh bout of ghastly news from Iraq: two American hostages were beheaded there this week and there are no signs that security is improving (see article). But even allowing for the grisly topicality of Iraq, this could prove the most important speech of Mr Kerry's campaign, because it replaced the phoney debate on national security with a real one.

Claiming that “invading Iraq has created a crisis of historic proportions”, Mr Kerry argued that the choice in November lies between sticking with failure or changing course to avoid “war with no end in sight.” For the sake of clarity, but at risk of more self-contradiction, he turned his back on his previous assertion that, knowing what he knows now, he would still have voted as he did. Instead, he attacked Mr Bush's insistence that he would have made the same decision again: “Is he really saying that if we knew there were no imminent threat, no weapons of mass destruction, no ties to al-Qaeda, the United States should have invaded Iraq? My answer, resoundingly, is no.”

To address the question of what he would have done differently, Mr Kerry put forward a four-point plan:

get more international help; “get serious” about training Iraqi security forces; change the reconstruction process and create a United Nations protection force to oversee elections planned for January.

Immediately after the speech, the Bush campaign fired back, counting 14 contradictions with Mr Kerry's previous positions. “My opponent continued his pattern of twisting in the wind,” claimed the president, adding that Mr Kerry's plan is no different from what America has been doing anyway. The next day, Mr Bush used his annual address to the UN to serve as a second, partial rejoinder. His speech was not about Iraq as such. But by presenting the country as a working example of American boldness doing good in the world, he drew an implicit contrast with Mr Kerry. It is not enough merely to talk about lofty goals, Mr Bush said; you must act.

More pessimistic, but convinced America is doing good

American public opinion (registered voters) on Iraq, %

	Sept 20th-22nd*		Aug 2nd-4th	
	Yes	No	Yes	No
Do you feel optimistic about the long-term prospects for democracy?	40	48	44	41
Should US troops be withdrawn during the next few months?	41	49	40	49
Is life better for Iraqis now than when Saddam Hussein was in power?	51	31	56	27
Overall, was it worth going to war?	44	47	41	49
Did the US make a mistake in sending troops?	46	46	47	44

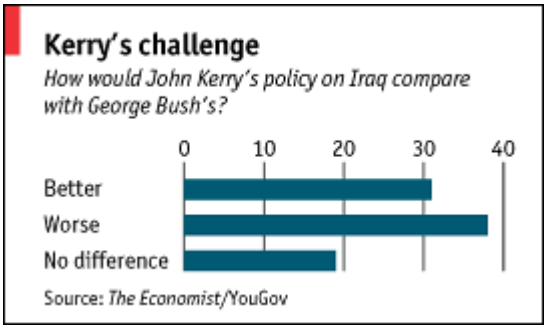
Source: *The Economist*/YouGov *Poll of 1,792 registered voters

It would be too much to say the two men have staked out clear differences on everything to do with Iraq. (It is not certain whether Mr Kerry thinks the war was a bad idea or a botched one: he still seems to be trying to have it both ways.) But real differences have now appeared on three of the most important questions:

• **How is the war going?** In his UN speech, Mr Bush argued that Iraq is making progress to democracy. Iraq's prime minister, Iyad Allawi, then claimed “we are defeating terrorists.” Mr Kerry argued that “raw sewage fills the streets, rising above the hubcaps of our Humvees;” that the administration has been exaggerating the progress in training Iraqi security forces; and that reconstruction is a failure.

On the whole, voters agree with Mr Kerry. Our YouGov poll (full results here) shows pessimism about long-term prospects for democracy in Iraq has increased sharply since early August. Three Republican senators—John McCain, Richard Lugar and Chuck Hagel—have worried aloud that the administration is painting too rosy a picture in Iraq (“right now, we are not winning,” says Mr Hagel). The army has admitted parts of Iraq are no-go areas. And the recent national intelligence estimate, a consensus of America's spies, gives three prognoses: bad (tenuous stability), worse and worst (civil war).

• **Is Iraq part of the war on terror?** Yes, says Mr Bush. At the Republican convention, he asked “Do I forget the lessons of September 11th and take the word of a madman, or do I take action to defend our country?” No, says Mr Kerry: the war is a distraction from al-Qaeda and has created the very terrorist havens that the administration claimed to be acting to destroy.



On this question, voters are undecided. The number of those who think Saddam and al-Qaeda were linked has fallen; just over half now say the war has not reduced the chance of a new terrorist assault on America; but roughly equal numbers think the Iraq campaign has strengthened and weakened the war on terror.

• **Should America pull out?** Mr Bush has said American troops will stay until Iraq has a stable government. Mr Kerry said his goal is to withdraw soldiers within four years, starting next summer.

Mr Kerry may be taking a risk here. He says he would not abandon Iraq, but talks of pulling troops out—which looks like a muddle or a smokescreen for retreat. If previous conflicts are any guide, Americans may well respond to reverses by demanding that more troops be sent in search of victory. Yet Mr Kerry's position seems in tune with many voters: in a Harris poll in mid-September, 38% said troops should stay until there is a stable government; 54% wanted them home next year.

Throughout the campaign, Mr Bush's team has insisted that any debate about Iraq was good for him because it plays to his strength as a war leader in a period of national security threats. On the other hand, Mr Bush's standing has marched broadly in step with events in Iraq: rising after the handover of power took Iraq out of the news in the summer; falling during the brutal spring, and again now.

By staking so much on Iraq, Mr Kerry is certainly taking a gamble—one that partly reflects the failures of his campaign so far (see Lexington). But at least voters will get to hear the candidates debate the merits of Mr Bush's actions—and not just what they did or didn't do in a war 30 years ago.

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Texas politics

Hammering the Hammer

Sep 23rd 2004 | AUSTIN
From The Economist print edition

A spot of local bother for Tom DeLay

IN TEXAS when somebody spits in your beer, you throw the glass back in his face. Nobody has used the local Democrats as a spittoon more gratuitously than Tom “the Hammer” DeLay. Hence the Democrats' cheers this week when a criminal investigation of Republican fundraising in Texas reached the inner circle of the House majority leader.

On September 21st, prosecutors from Travis County led by Ronnie Earle (as it happens, the only Democrat left with any real power in the state) indicted three friends of Mr DeLay and eight corporations said to have contributed to Texans for a Republican Majority, a group the former pest exterminator founded, on 32 felony charges. The prosecutors claim that some $2.5m of corporate money was illegally used to help the Republicans in the 2002 state legislative elections. (Those elections wiped out the last vestige of Democratic rule in Texas and set the stage for Mr DeLay to bully through a congressional redistricting bill that could add five new Republicans seats in the House.)

Texas has a century-old ban on corporate political contributions. Those indicted this week include Jim Ellis, one of Mr DeLay's leading political aides, John Colyandro, whom Mr DeLay chose to run Texans for a Republican Majority, and Warren Robold, a long-time DeLay fundraiser. The firms indicted include Sears, Roebuck, Cracker Barrel Old Country Stores and Westar Energy.

All the defendants firmly deny any wrongdoing. They say they bent over backwards to adhere to a law one defence lawyer has called “gooey”. The Hammer, who has not been charged or even subpoenaed, has pointedly questioned Mr Earle's timing in issuing indictments just 41 days before the election. Mr Earle says the charges are only the first phase of a campaign to stop firms “controlling representative democracy in Texas.'' Expect more violence—legal, political or both—shortly.

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Campaign-finance disclosure

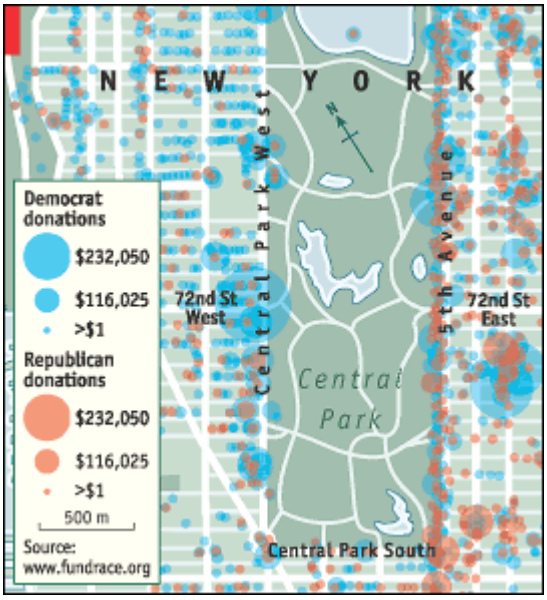
Keeping up with the Joneses

Sep 23rd 2004 | BOSTON
From The Economist print edition

A distinct threat to neighbourly goodwill

TYPE in your home address at the website fundrace.org and sneak a peek at your neighbours' political donations. Or choose a postal code—say, Beverly Hills 90210—and see a list of who gave how much to whom. Your correspondent, from his modest Boston pad, discovered some unexpectedly ritzy nearby residents: the vice-chairman of a huge media company, who gave $30,000 to the Democrats, and the chairman of a big medical-device firm who, with his wife, contributed $50,000 to the Republicans.

Public disclosure of political contributions is a pillar of democratic accountability. But how much transparency is too much? The current disclosure-enforcement rules were established in another era: in 1974, after Watergate, when records were mainly on paper and further snooping meant a visit to the Federal Election Commission in Washington, DC.



The internet changed that. The FEC now makes its data openly available for download (though the law forbids its commercial use). A number of websites have made the information searchable online for years. This was relatively tame until an enterprising group of technology-inspired artists, called Eyebeam, matched the information with geo-location data and enhanced search capabilities, and then mapped big cities down to the buildings. The results are online at www.fundrace.org. (Their map of uptown Manhattan, shown above, supports the stereotype that the posh, buttoned-up Upper East Side leans towards the Republicans, while the slightly less well-to-do but more hedonistic Upper West Side is predominantly Democratic.)

The beauty of address-based snooping is that it allows the voyeur to see through disguises, such as allegedly impartial figures getting their spouses to give money. (A lot of politics professors seem to take this route.) It does not, however, track the money going to pseudo political groups, like the so-called 527 organisations.

Perhaps giving, like voting, should be anonymous? Voting was actually public in America until the end of the 19th century. Ian Ayres, a professor at Yale Law School and co-author of “Voting with Dollars”, thinks the answer is private donation booths; these would prevent candidates from knowing whom they owed special favours, just as secret ballots do. But if campaign gifts were anonymous, there would probably be fewer of them.

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Medicare reform

Grandma's little helper

Sep 23rd 2004 | WASHINGTON, DC
From The Economist print edition

The prescription-drug benefit is not helping the president as he hoped

WHEN George Bush signed the law expanding Medicare coverage to prescription drugs last December, he called it a “victory for all of America's seniors”. To many in the White House, the law seemed a brilliant political coup. It would appeal to older voters, allow Republicans to boast about success on the traditionally Democratic turf of health care and prove that Mr Bush could get things done. Of course, it was expensive—but cheap pills were a sure route to getting grandma's vote.

Nine months later, things look rather different. Medicare has become one of the nastier domestic issues in the campaign, and the drug benefit is less a vote-buyer than a lightning rod. The White House's biggest problem comes from rising Medicare premiums. One day after Mr Bush bragged at the Republican convention that he would “honour America's seniors” by helping them with their drug bills, the administration announced that Medicare premiums would rise by 17.4% next year, the biggest annual increase ever.

Mr Kerry aired a television ad, accusing Mr Bush of “broken promises” and said that he would roll back the premium rise. Team Bush countered with an ad that accused Mr Kerry of “Medicare hypocrisy”: the premium increases were defined by a formula set in a 1997 balanced-budget law that Mr Kerry had supported.

In terms of substance, Mr Bush is on stronger ground. Higher premiums are a way of obliging old people to shoulder some of Medicare's rising costs. By promising to splurge more money, Mr Kerry deserves to lose any claim to the mantle of fiscal responsibility. But politically the fracas has given a rare lift to Mr Kerry, who has anyway been hammering the administration on the content—and cost—of the prescription-drug benefit.

Mr Kerry claims that the law does more to boost the profits of drug companies than the health of older Americans. He is also promising to repeal the provision that forbids Medicare to negotiate lower prices with drug manufacturers (a position that is wildly popular among old folk). And he accuses Mr Bush of illegally hiding the drug bill's true cost.

While lobbying for the drug bill's passage, the White House claimed it would cost $400 billion over a decade. Soon after the law passed, the official estimate had gone up to $534 billion. It is now clear that the administration's own experts projected a higher cost, and were bullied into silence. (A recent report from the General Accounting Office recommends that the chief bully, the former Medicare administrator, be asked to repay part of his government salary.) More recent government documents suggest that the projected ten-year cost has gone up again, to $576 billion. And the drug benefit will cost $1 trillion in its second decade.

This explains why so many Republicans privately fume that this was an extraordinarily costly bit of vote buying. Their more immediate worry, though, is how few votes it seems to have bought. Despite a $30m publicity campaign, paid for by the government, 47% of old people and those on disability had an “unfavourable impression” of the new law, according to a poll by the Kaiser Family Foundation in August. But most people want the law fixed, not repealed.

The most powerful group is the AARP, which represents 35m older Americans. Some 60,000 members left the AARP in protest after its leadership supported Mr Bush. Those leaders are now distancing themselves from the White House, saying they are determined to improve the law and demanding more legislation to cut drug costs, such as legalising the reimportation of drugs from Canada.

The White House underestimated the confusion the new law would cause. Any big change in the vast Medicare bureaucracy risks chaos, but this law is spectacularly complicated. Most of the changes do not start until 2006. The one benefit that people can see before the election—the introduction of drug discount cards—is only temporary. These Medicare drug cards, introduced in June, have many good features. They bring discounted prices, and poorer Americans get a $600 credit on their cards. But relying on a website to help people work out which card brings them the cheapest drugs has proved a blunder: only one in four older Americans has ever used the internet. Although more people are gradually signing up, only 4.3m Americans now have these cards.

There is some evidence that Mr Bush's push on health care has helped shore up what is usually a Republican weak point: our YouGov poll last week showed 65-year-olds evenly split on which candidate would reduce their Medicare premiums. But judging by the frequency with which he addresses the issue, Mr Kerry clearly reckons the Medicare drug bill helps him. And back in August the Kaiser poll found that only one in 20 elderly voters were more likely to vote for Mr Bush because of the drug bill. That's not much of a return for an almost $600 billion bribe.

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The electoral week

On the trail

Sep 23rd 2004
From The Economist print edition

Such a nice man (1)

“Dear Sophia, Thank you for supporting my campaign. I understand someone tore up your sign. So I am sending you a new sign and a signed picture. Please give my best to your family. Sincerely, George W. Bush.”

A letter to three-year-old Sophia Parlock whose Bush-Cheney poster was torn up at a Kerry-Edwards rally. US News and World Report, September 27th

Such a nice man (2)

“I think he's a perfectly nice guy. I don't know him, really, but it's not personal.'

John Kerry on George Bush. New York Times, September 20th

The poll that really counts

According to Buyseasons, a costume company, sales of Bush Halloween masks are outselling Kerry masks by 57% to 43%. Spookily, sales of Halloween masks have correctly predicted the results of the last six elections.

CNNmoney.com, September 21st

Wouldn't we all?

“It's something we'd rather not get involved with, I'd rather crawl in a hole.”

An Amish farmer from Ohio. Only one in three Amish vote—they prefer to pray for the candidates; but the Ohio Republicans are chasing them. Columbus Dispatch, September 20th

Bushism of the week

“They were telling me just the amount, the number of people that have showed up just to provide help, the people that have heard a call to love a neighbour in a time of distress.”

The president reporting on orgies in Southwind, Florida, while visiting victims of Hurricane Ivan. Pensacola News Journal, September 20th

The international view

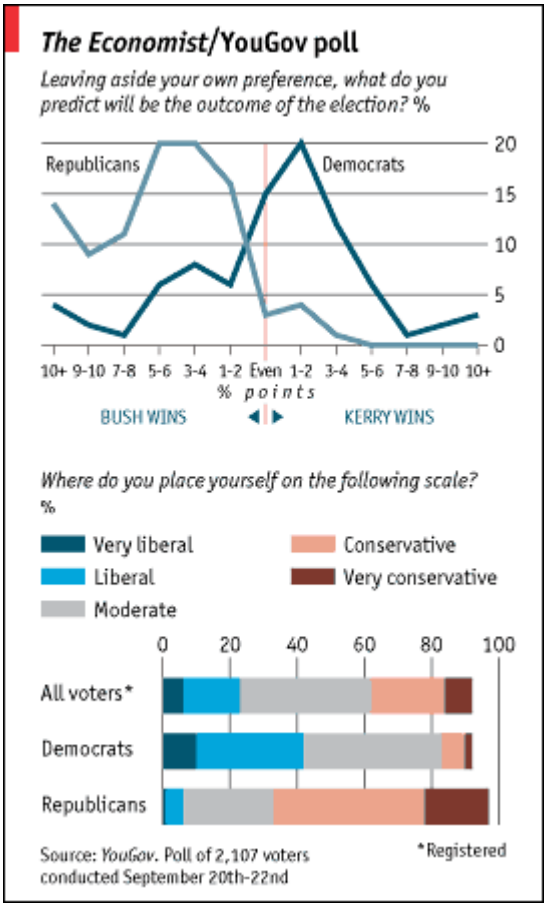
“There is a problem, you see, with public buildings. Batman got into Buckingham Palace and Bush got into the White House. It's an absolute tragedy. So we've got to find a way of dealing with it.”

Tony Benn, a grand old man of the British left, fires yet another shot at the current president. “Any Questions?”, BBC, September 17th

Father Ted

“I'm scared to death when the left, the hippies, the MTV parolees go, ‘Just get out and vote’. That's not good enough. It's like saying, ‘Well, there's a child drowning in the river. Just do something. Here, I'll throw him a cinder block.’ ... I see this ‘Just vote’ from Puffy, Daddy, or whatever he is, to be frightening, pipe-dream, fantasy-world, youth ignorance.”

Ted Nugent on P. Diddy's “Citizen Change” get-out-the-vote initiative. US News and World Report, September 27th



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Health spending

The older they get, the more they cost

Sep 23rd 2004
From The Economist print edition

How much spending on health care goes to old people?

IN THIS election no group is treated with more respect than “seniors” are. One in six adult Americans is above 65 years old, but they may well account for one in four voters; hence the attempts to spend ever more on their health. But do the elderly really get such a rough deal?

The main chunk of public money spent on old people's health is Medicare, which cost $281 billion—2.6% of GDP—in 2003. Not all this money goes to old people: around 15% of Medicare's 41m beneficiaries in 2003 were under 65, because the programme also covers some of the working-age disabled. But the oldsters more than make up for this elsewhere.

Take, for instance, Medicaid, the joint federal-state programme that pays for health care for poor people and cost about $270 billion last year, according to the Congressional Budget Office. Some three-quarters of the 51m individuals enrolled in Medicaid in 2003 are poor children, their parents and pregnant women. Yet they receive little more than a quarter of the benefit payments. The lion's share of the money goes to the old and the disabled. The old, who comprise only 10% of the beneficiaries, account for 28% of Medicaid spending.

Put these numbers together, and the elderly, who make up about 12% of America's total population, consume nearly 60% of spending on the country's two biggest health-care programmes: an amount equal to around 3% of GDP. And that does not include other ways in which old people get their health care paid for by the government—such as the close-to-$30-billion that goes to veterans' health care.

In one way there is nothing unusual in this. The costs of medical care are concentrated in the final years of life—something that is reflected in health-care spending in every country. But two things may begin to irk younger Americans. First, America's generosity to the old stands in marked contrast to the lack of coverage offered to other age groups—notably the 45m people who have no health insurance.

Second, the elderly's share of the pie is bound to increase. In 2006 Medicare will start to pick up a big chunk of the cost of prescription drugs for the elderly, pushing up the cost of that programme alone to 3.4% of GDP. At the end of this decade, the huge generation of baby-boomers will start to swell the ranks of the old. By 2024, outlays on Medicare will exceed those on the Social Security pension system. By 2030, when there will be almost 80m beneficiaries, spending on Medicare alone will reach 7% of GDP—the same proportion as Britain spends on its National Health Service, which covers everyone.

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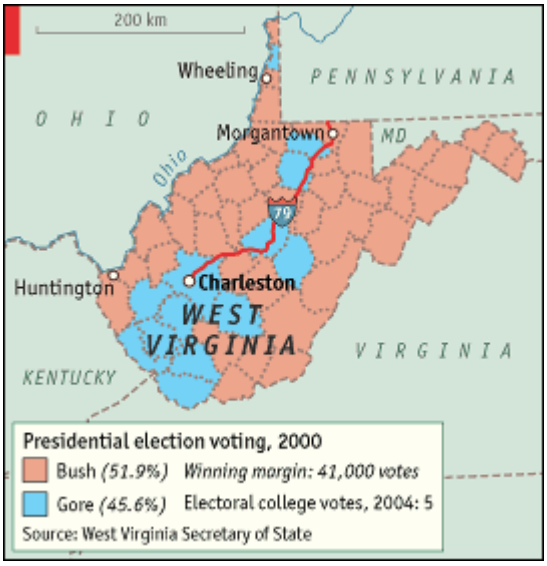
Swing states

Not Kerry country, but not quite Bush country either

Sep 23rd 2004 | CHARLESTON
From The Economist print edition

West Virginia was an unexpected Republican gain in 2000; is it still a swing state?



IF JOHN KERRY is to recapture any of the states George Bush won four years ago, it should be West Virginia. The state has twice as many registered Democrats as Republicans. Both Democratic senators won in landslides. This year, Joe Machin seems likely to repeat the feat in the governor's race: he is 32 points ahead.

Al Gore ignored West Virginia till the last minute, was seen as a radical environmentalist in a state where coal is vital and was accused by the National Rifle Association of wanting to take your guns away—akin, says the current chairman of the state Democratic Party, of wanting to take your baby-pictures away. And he still lost by only six points. Mr Kerry, a veteran in a state where the armed forces are prominent, has not made those mistakes.

There is a more personal reason why Mr Kerry should win. In many states, cultural and economic attitudes are aligned. In the south, both tend to be conservative; in the north-east, both trend to the left. In a few states, notably in the west, voters describe themselves as socially liberal, but economically conservative. But West Virginia is the opposite. It is socially conservative and economically leftish—strongly religious, zealously patriotic, yet with big unions and strong support for public spending and protectionism. Mr Kerry—at least in his public persona—shows a somewhat similar combination. His economic policies are modified old-fashioned Democratic ones. But he waves guns around, boasts about his conservative values and surrounds himself with vets.

It does not seem to be working. Polls in West Virginia are unreliable, but most show Mr Bush ahead by a few points. Democrats moan about a new low in dirty tricks: they stand accused by the Republicans of wanting to ban the Bible. But there are also more straightforward things helping Mr Bush. For once, the economy is in less dreadful shape than usual. And the president's likeability stands him in good stead (because of “West Virginians' affinity with plain speaking” says the state's Republican congresswoman, Shelley Moore Capito). By contrast, Mr Kerry's notorious claim to have voted “for the $87 billion [Iraqi reconstruction bill] before I voted against it” was made in West Virginia.

On top of all that, suggests Chris Stirewalt, the political editor of the *Charleston Daily Mail*, West Virginia's obeisance to authority may help Mr Bush slightly. Having lived with a corrupt political machine so long (accusations of vote-buying rumble on), West Virginians have learned to stay on the right side of power. Before 2000, the only times they voted for a Republican as president was when they re-elected the incumbent.

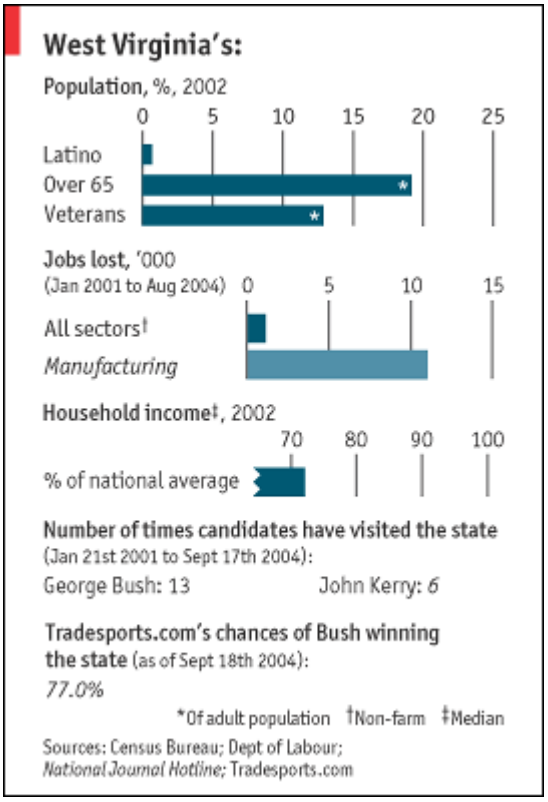
The big question is how far the shift towards Republicans will go. Looking at the state's conservative attitudes and the decline of union jobs, party loyalists are waiting for the dam to burst and the state to gush into the Republican column, as happened in the south two generations ago. They may wait a while longer. In the south, the change began from the bottom up; Republican presidential victories came later. In West Virginia it has been the other way around. There has been only a small shift in party affiliation and the local Republican organisation is weak.

But the main reason for thinking West Virginia is a swing state, not an emerging Republican one, has to do with regionalism. West Virginia is barely bigger than Allegheny County in neighbouring Pennsylvania

(which includes Pittsburgh). Yet the state contains five regions, each with distinct characteristics.

In the northern panhandle (the bit that sticks up between Ohio and Pennsylvania), steel is—or was—king: hulks of abandoned steelmills line the Ohio river. The rural south is coal country, the heart of the state's Democratic machine. The current governor, three of the five statewide elected officers and the leaders of both houses all come from here.

But the mechanisation of coal—employment in the mines has halved in ten years—has shifted the state's centre of power. Both candidates for the governorship come from the north-central stretch along Interstate 79, with its smattering of technology and medical jobs spun off from West Virginia University. But the fastest-growing part of the state—and the most Republican—is the eastern panhandle, an exurb of distant Washington, DC, full of rich commuters and fast-rising property values. While schools close in the rest of the state, here they are overcrowded. The rest contains the underpopulated mountain range on the Virginia border and the "metro valley" of the capital, Charleston.



Because the Democratic parts of the state are in steep decline, reckons Mr Stirewalt, the party machine, with its base in the southern coal fields, could fall apart by the next census in 2010. But that will not itself make West Virginia Republican. With its mixture of new exurbs, old coal fields, rustbelt and technology corridors, the state looks more like the mid-west—Ohio, Pennsylvania, even Missouri—than its southern neighbours. It is heading for parity, not Republicanism.

This may be good for the state. West Virginia's curious combination of conservative values and liberal economics has roots in a somewhat xenophobic culture. There is a common prickly sense that the state has been left behind—its industries neglected by out-of-state owners, its traditional values supposedly out of favour with the prevailing culture. Greater national attention may disrupt its sense of isolation. But for Mr Kerry, the news is not so good. The Democrat is struggling in a state that is becoming gradually more like the rest of America.

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Lexington

The comeback Kerry

Sep 23rd 2004
From The Economist print edition

How the Democrat can revive his faltering campaign

Get article background

IN SEPTEMBER 1980 Ronald Reagan was stuck behind Jimmy Carter in the polls. His campaign was in such a shambles that he had to sack his campaign manager. And he was dogged by the belief that he was unelectable. All that changed with a single debate—and Reagan crushed Mr Carter by more than 8m votes.

John Kerry is no Ronald Reagan (though one supporter recently introduced him twice as John Kennedy). But he still has time to turn his campaign round. It is true that the Republicans have the wind in their sails at the moment (New Jersey is now considered a swing state, for heaven's sake). But swing voters seem in an unusually volatile mood. Mr Kerry still has a lot going for him—particularly the energy of a Democratic rank-and-file that will do anything to get George Bush out of the White House, and widespread worries about where the country is heading.

How can Mr Kerry translate all this energy and anxiety into victory? This week the Kerry camp produced a surprising answer: focus on Iraq. Mr Kerry had originally planned to spend the autumn talking about the economy and health care. But now—thanks to the influence of a group of Clintonites who have been drafted into his campaign—he has put Iraq at the centre of his campaign. Mr Kerry's pivotal speech in New York this week, ripping into Mr Bush's Iraq foray, may prove similar to Hubert Humphrey's denunciation of the Vietnam war in late September 1968, which narrowed the gap with Richard Nixon.

Why choose Iraq? After all, Nixon still won in 1968. And Mr Kerry's performance on Iraq has been dismal. While Mr Bush has stuck to a simple message (that the war in Iraq is an essential part of the war on terror), the Democrat has tied himself in ever more elaborate knots. It is hard to think of a position on Iraq that he has not taken. For all that, he is probably right to focus on it.

This is partly to do with the paucity of alternatives. Mr Kerry's standard speech thus far has been a general attack, typified by his meandering midnight rebuttal of Mr Bush's convention speech. In theory, this provided a way to pick off groups of wavering voters. But it has also reinforced the impression that Mr Kerry is a long-winded senator with no priorities.

So he has to focus on something. Why not that old Clinton staple, the economy? Or one of the issues where the Democrats have a clear advantage, such as health care? Mr Kerry has certainly turned up the volume on Mr Bush's domestic record. But it does not look enough to win through. First, the economic news hardly looks bad enough. And, second, the war on terror (broadly defined) seems to be the main issue of this electoral cycle; back in 2002, the Democrats were hammered in the mid-terms when they tried to focus on domestic policy, in effect ceding national security to the Republicans.

Mr Kerry's advisers insist that Iraq should be his issue. The grisly newspaper headlines, with their catalogue of beheadings and bombings, could easily shift public opinion against Mr Bush. But how can Mr Kerry make a better job of the subject?

Some of his reshaped strategy looks obvious. He should stop agonising publicly about his two notorious Senate votes (in favour of giving Mr Bush war powers and against giving him $87 billion to pay for the war). If the election becomes a referendum on his voting record, he is done for. Similarly, he needs to stop worrying about offending factions within the Democratic Party. The Democrats hate Mr Bush so much that they will follow Mr Kerry wherever he leads, as long as it is not round in circles.

But which direction should he take? Mr Kerry's speech this week shows he is still torn between two positions—condemning the war outright (he called it a mistake) and focusing on the management of the conflict (he claimed Mr Bush was not doing enough to win the struggle). The first would thrill many Democrats; but it would also surely delight the Republicans, giving them a golden opportunity to paint him as a peacenik leader of a peacenik party. Mr Kerry didn't defeat Howard Dean in the snows of Iowa only to morph into him eight months later.

The competence question

“Mismanagement” certainly offers a less thrilling rallying call. (It is unfortunate that Mr Kerry's old boss in Massachusetts, Michael Dukakis, is forever associated with the idea that an election can be about competence rather than ideology.) But in this particular case, it surely offers Mr Kerry a better line of attack.

First, it is a far less contentious charge to prove. By any reasonable standard, the White House has a mind-boggling record of incompetence in Iraq, from the lack of post-war planning to the disgrace of Abu Ghraib. Mr Kerry can tap into the sense that Mr Bush is out of touch with what is happening on the ground, especially in Iraq's no-go areas. The more Mr Bush repeats his mantra about the march of liberty, the more he risks sounding like a Texan version of “Comical Ali”, the Iraqi propaganda minister who declared that the infidel dogs were in retreat even as American troops rolled into Baghdad.

Second, Mr Kerry can broaden the theme of mismanagement. Look, he can argue, the same idealistic incompetence that has dogged the Iraq war can be seen throughout the administration's policies: witness, for instance, its fiscal recklessness in cutting taxes while increasing spending.

Lastly, focusing on mismanagement allows Mr Kerry indirectly to deal with one of his biggest handicaps—the likeability gap. Most Americans have a soft spot for Mr Bush (and recoil from assertions that he deceived them into an unnecessary war). But many also have a sneaking worry about his competence. Is the amiable frat boy really a match for our dangerous times? Or is he being manipulated by ideological zealots? If Mr Kerry can use Iraq to reinforce doubts about Mr Bush's competence, then he has a chance of pulling off a Reagan; but like Hubert Humphrey, he does not have much time.

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Canada's government

Martin sets out his stall of sweeteners

Sep 23rd 2004 | OTTAWA
From The Economist print edition

Austere when finance minister, the prime minister is full of largesse

Get article background

BY MOST yardsticks an effective finance minister for ten years under Jean Chrétien, Paul Martin has been oddly disappointing since he stepped up to become Canada's prime minister last December. He came perilously close to losing an election in June that had been intended to give him a personal mandate and his Liberal Party a fourth term; the Liberals were reduced to a parliamentary minority, with just 135 of the 308 seats in the House of Commons. Yet as political Canada stirs from its long summer break, Mr Martin has lost no time in starting to implement his new government's main objectives.

On September 16th, after a testing three-day conference—much of it televised—the prime minister pulled off a deal with the provincial premiers on health care. In doing so, he began to fulfil his main election promise. The deal will cost the federal treasury an extra C$41 billion ($31.5 billion) in transfers to the provinces over the next ten years. But with that money Mr Martin has also handed back to the premiers the problems of launching a national drug strategy, improving home care, recruiting medical staff and cutting waiting lists. He insisted, too, that the provinces must account for how the money is spent.

More broadly, the conference restored a co-operative spirit to federal-provincial relations—absent since the days of Lester Pearson, Canada's prime minister in the 1960s. The meeting had begun with predictable whingeing from the premiers about the miserliness of the federal government, whose share of health spending plummeted when Mr Martin, as finance minister, was taming federal deficits. The mood changed when the prime minister doubled his initial offer of new funds and included an escalator clause guaranteeing an annual 6% increase. In private talks lasting past a midnight meal of pizza, he was emollient—a contrast with Mr Chrétien's often brusque handling of the premiers.

Mr Martin also showed flexibility. He offered Quebec a separate deal, recognising that its health system is different from those elsewhere. Jean Charest, Quebec's Liberal premier, who is struggling to modernise public services, was jubilant. He secured not only the approval of the other premiers to this side deal but also that of Stephen Harper, the leader of the federal Conservatives, whose home province of Alberta is jealous of any special status for Quebec. But this was not enough to prevent the Liberals losing two seats in provincial by-elections in Quebec this week.

The government is moving to implement other spending promises. Next in line for pizzas and cash are

the big-city mayors: they have been promised an extra C$5 billion over the next five years from petrol taxes. This money will start flowing next year, according to John Godfrey, the minister responsible. Mr Martin has also promised a national child-care programme, perhaps modelled on Quebec's system, and an extra 5,000 troops for the armed forces, which are overstretched by peacekeeping duties. To pay for all this, the government is looking for savings of C$12 billion in other spending.

Critics such as John Manley, a former Liberal finance minister, say that Mr Martin gave away more than he intended on health care, and that he will not be able to afford his other election promises without going into debt. And Mr Martin's talk of Quebec as a “distinct society” is risky. It will go down well in the French-speaking province, where the Liberals were mauled by the separatist Bloc Québécois in the election. But it is a portentous phrase which torpedoed the Meech Lake talks on constitutional reform in the 1980s; it will grate in the west.

A democratic deficit

Mr Martin's second main promise is to repair what he calls a “democratic deficit”, by making parliamentary business more open, allowing more free votes and greater scope for committees. Televising the health-care talks was a risky but successful step. The prime minister's office has also offered to reduce its own powers of patronage—thousands of high-level jobs are traditionally in its gift. The aim is to move towards a more open system without aping the partisan interrogation of judges and ambassadors in the United States.

The government's first effort—the naming of two women judges to vacancies on the Supreme Court and their screening by an ad-hoc committee of politicians and lawyers—was done in a rush in August. It was greeted with public derision. Irwin Cotler, the justice minister, told the committee that it could not question the judges; that would politicise the process, he said. One pundit compared Mr Cotler's appearance in their stead as “sending your mother to your job interview”.

Despite such slips, Mr Martin's new-found largesse may grease the Liberal path to a fresh election. Neither of the two main opposition parties wants an early vote. The recently merged Conservatives (with 99 MPs) are holding an inaugural policy convention in March; Mr Harper said he has no plans to topple the government before then. The Bloc knows it is highly unlikely to better its June haul of 54 seats.

So Mr Martin could doubtless survive for two years or so. On social issues, such as legalising same-sex marriage, he would have support from the leftish New Democrats (19 MPs) and the Bloc. The Conservatives would probably support any government decision to join in an American scheme for ballistic-missile defence.

Mr Pearson successfully led a minority government for five years in the 1960s. If there is an early election, it may be of Mr Martin's volition. Some in Ottawa predict that the government could be tempted to produce a budget next February designed to invite an opposition vote of no-confidence. That would catch the Conservatives before they have a new set of policies and capitalise on the government's big new handouts and the strong economy. But is Mr Martin, scarred by his near-death experience last June and known to dither over political choices, prepared to jump that soon? Either way, his position is stronger than it looks.

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Haiti

Inundated

Sep 23rd 2004 | GONAÏVES AND PORT-AU-PRINCE
From The Economist print edition

An unnatural disaster adds to a hapless country's hardships

EPA

The sea of mud that engulfed Gonaïves

Get article background

THE deadliness of a storm depends not just on its own strength but on the weaknesses of the country it hits. Though tropical storm Jeanne was less fierce than the preceding Atlantic hurricanes, it killed far more people: in hapless Haiti, more than 1,000 died and another 1,000 were missing after heavy rains last weekend triggered mudslides and flash floods. It was yet another blow to the poorest country in the Americas: in May, floods killed more than 1,000 in the east, while in February Jean-Bertrand Aristide, the country's president, was ousted amid political turmoil, armed rebellion and looting.

In Haiti, natural disasters are both cause and consequence of the indescribable misery of the country's poor majority. For decades, peasant farmers have chopped down trees to make charcoal for cooking; water runs off the denuded hillsides, taking the topsoil with it.

Jeanne dumped heavy rain both on the next-door Dominican Republic (where 19 died) and on north-western Haiti. Swollen rivers burst their banks and engulfed Gonaïves, a port city of 200,000. On September 22nd, half the city was still under fetid water and a thick layer of mud. Many of those left homeless took refuge on roof tops; others sought sanctuary on the second floor of the cathedral.

After the flood came disease and hunger. Gérard Latortue, Haiti's interim prime minister, declared a national emergency. The United Nations, which has a peacekeeping force in the country, began to deliver food and drinking water to Gonaïves. But the aid effort was slow to get going. Hundreds of people lined up for rations of rice and sunflower oil—but some had nothing left to cook with. UN officials hired local gang leaders to keep order. The storm destroyed part of the barracks used by peacekeepers; Argentine doctors treated the injured at a makeshift open-air clinic.

The latest disaster adds to the difficulty of reconstructing Haiti's economy and government. Mr Latortue, an economist who himself worked for the UN, has assembled a team of technocrats to steer the country to new elections next year. In July, donors pledged $1.5 billion in loans and aid. But little of this has been disbursed; officials from the World Bank and other donors were meeting in Port-au-Prince, the capital, this week to try to find ways to speed the aid flow.

To make matters worse, many parts of the country are not

under the government's control. Last week, it reached a tentative agreement with the rag-tag rebel army which toppled Mr Aristide. Most of the rebels were once soldiers in Haiti's army, disbanded in 1995. They agreed to turn over their guns in return for a small pension and an indemnity for losing their jobs. But when will that in fact happen?

The UN has been frustratingly slow to build its peacekeeping force up to the 6,700 troops that were promised in April. So far only 2,750 blue helmets have arrived, mostly from Brazil, Chile and Argentina. UN officials say they hope to have 5,000 troops by the end of October.

The rebels are not the only threat to security. Gangs of toughs (known as *chimères*) who supported Mr Aristide have turned to crime. Armed robbers and kidnappers appear to act at will. Last week Jean Moles Lovinsky, a protestant pastor whose popular morning radio show made him one of Haiti's most-loved public figures, was shot dead by muggers. A visiting French minister had to be extricated by Brazilian troops after being pinned down in Cîté Soleil, a vast slum, for two hours by gunmen loyal to Mr Aristide.

The patience of ordinary Haitians is starting to run out. After the aid package was signed in July, Mr Latortue promised that by September a reconstruction programme would finally get under way. The floods may now set that back further—though the need is all the greater.

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Farming in Mexico

From corn wars to corn laws

Sep 23rd 2004 | CAPULALPAM, OAXACA
From The Economist print edition

A national nervous breakdown over maize

IN THE village of Capulalpam, high up in the Sierra Madre mountains of the state of Oaxaca in southern Mexico, a local woman proudly shows off her small plot of farmland. The courgettes are almost as big as footballs and her maize plants tower above her. The secret, she confides, is the quality of her pigs' excrement. She insists that all her produce is completely organic. Here, that claim means something more than usual: Capulalpam was where, in 2001, unregulated genetically modified (GM) corn was first found in Mexico. That set off a national debate that at times has looked more like a national nervous breakdown—especially since the source of the offending corn was the United States. Now, Mexico is about to enact a bio-security law which may fashion some sense from the confusion.

Corn, or maize, matters to Mexico more than to any other country in the world. It is indigenous to Mexico, and has been cultivated there for some 6,000 years. The country is home to more varieties of maize than any other. It remains the staple of the Mexican diet, in everything from tortillas and tacos to tamales and soup. Amanda Gálvez, a food scientist at the National Autonomous University, reckons that the average Mexican gets 40% of his protein intake from corn, of which he eats between 250 and 400 grams (8-14 ounces) a day. It is also a cultural staple. Many Mexican Indians in southern states such as Oaxaca believe that the maize plant represents the origin of life itself.

All this has made GM maize an unusually sensitive issue. In 1998, the government declared a moratorium on planting and experiments with GM maize—though not for other GM crops and plants. But this ban does not apply to imports. Inefficient farming and a rising population mean that Mexico now imports some 6m tonnes a year (about a quarter of its needs) from the United States under the North American Free Trade Agreement (NAFTA). About 30% of this imported corn is GM, according to Exequiel Ezcurra, the director of the government's National Institute of Ecology. These imports are probably the source of the GM corn found in the Sierra Madre.

Traditionalists worry about unintended pollution of the world's purest genetic stock of maize. Although no confirmed finds of GM maize have occurred on Mexican farms since 2003, few doubt that it is still present. Supporters of GM argue that Mexico's poor yields and droughts mean that it is precisely the sort of country that should invest in biotechnology. GM could help Mexico's many peasant farmers increase their output and incomes, and “decrease hunger”, says Luis Herrera-Estrella, a genetic scientist at the National Polytechnic Institute.

The blanket ban on GM research was lifted last year. But only in theory: no permits have been issued. For the past three years, Mexico's Congress has been discussing the whole issue. A law is likely to be approved, perhaps next month, which may strike a compromise. Greens want it to reaffirm the ban on experiments with GM maize, and to order stricter labelling of imports. Supporters of GM want a green light for planting and research.

The issue is becoming an urgent one. In 2008 remaining quotas on corn imports from the United States will be lifted under NAFTA. This will unleash an avalanche of cheap, subsidised GM corn from the American mid-west. The best response, say some Mexicans, is to adopt biotechnology. Ms Gálvez points out that while Mexico—once a world leader in this field—has been sitting on its hands for the past six years, the United States has granted 5,000 permits for research on maize alone.

Carlos Camacho, the president of AgroBIO, a business lobby, expects that the new law will introduce some flexibility. The requirements to get permits for planting and research will be exacting, “but at least you will know where the bar is,” he says. He argues that this will be an improvement on the current fog of obscure environmental protocols and fudged laws. At the same time, special areas of bio-diversity, like

Oaxaca, could choose to maintain a total ban. That is a rough-and-ready compromise—but better than the current self-defeating prohibition.

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Tourism in Bolivia

Not just for backpackers

Sep 23rd 2004 | LA PAZ
From The Economist print edition

Trips of nostalgia and emptiness

THE scenery is magnificent, rugged and pristine. The wildlife is varied and abundant. The cost of living is low. But Bolivia is hard to get to, and harder still to get around—even when protesters do not block roads. So, despite its obvious potential, the country's tourist industry has struggled: in 2002, it accounted for a puny 2.1% of GDP.

To entice more visitors, officials and tourism companies have come up with some new ploys. Next month, a Bolivian baroque orchestra, backed by 1,000 *zampoñas* (pan pipes) and 300 dancers dressed as devils, will serenade a hot-air balloon race. All this will take place at the Salar de Uyuni, a vast expanse of blindingly-white emptiness that is the world's largest salt flat.

Visiting Uyuni involves an arduous journey of several days over unmade roads. Some 60,000 tourists a year are said to do so, drawn by word of mouth. The musical bash is an effort to put Uyuni on the map—and help to turn Bolivia into a destination of choice, rather than an afterthought for visitors to Machu Picchu in neighbouring Peru.

Local authorities are also taking steps to ensure that tourists won't be trapped by protests, as happened last year. “Road blockades got us nowhere,” says Bernardo Quispe, a leader of five provinces surrounding Lake Titicaca who have formed a “pro-tourism alliance”. In fact, they got them a deal with the government: in return for not blocking roads, they are getting aid money for small-scale tourism projects.

Those who do make it to Bolivia tend to be backpackers. To attract older, wealthier tourists, Aerosur, a local airline, has refurbished two Douglas DC-3 Dakota aircraft that first saw service in the 1950s. With hostesses dressed in fashion of the same era, the planes started regular flights last month from La Paz to Uyuni. They have large windows, and fly slow and low—ideal for camera-touting tourists.

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Correction: the United States International Trade Commission

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Last week ("Time to bury the hatchet") we mistakenly described the United States International Trade Commission as "a branch of the Department of Commerce". It is in fact an independent, non-partisan, quasi-judicial federal agency. Apologies.

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China

What price reform?

Sep 23rd 2004 | BEIJING
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Hu Jintao's consolidation of power does not mean that democracy is on the cards

Get article background

AFTER 15 years at the helm, China's ebullient and irascible leader, Jiang Zemin, has completed the handover of power to a younger generation. The Communist Party appears to have carried out its first orderly succession, after a mere 55 years in power. But will Hu Jintao, who is now party chief, president and, since September 19th, supreme military commander, set his sights on higher goals and attempt to turn the sclerotic party into something more democratic?

In the weeks building up to the party conclave at which Mr Jiang, 78, finally surrendered his last post as head of the party's Central Military Commission, rumours swirled in Beijing of a power struggle between him and Mr Hu. Some political observers portrayed Mr Jiang as a conservative who was restraining the more reformist Mr Hu, who is a sprightly 61. If there was indeed a serious conflict—and the evidence is thin at best—Mr Hu appears to have emerged a clear winner. Vice-president Zeng Qinghong, Mr Jiang's chief ally in the Politburo, failed to get a place in the military commission, which Mr Hu now heads. This would tend to suggest he is not as much of a political threat to Mr Hu as many had supposed.

For all the speculation about Mr Hu's reformist tendencies, there is little to suggest that his strategy for reforming the party differs much from Mr Jiang's. It is likely that both men realise the need to adjust the party's dictatorial and secretive style to something more in tune with China's changed economic and social environment. And both accept that reform should proceed with caution, lest the forces it unleashes topple the party. Mr Hu made clear his bottom line in a speech on September 15th: “History has proved that in China copying the model of western political systems is a dead-end road.”

In the past couple of years, the party (under Mr Hu, but building on ideas fostered by Mr Jiang) has promoted small-scale experiments in scattered areas of China in the strengthening of “intra-party democracy”, a goal that many Chinese scholars see as an essential prerequisite to making the system as a whole more accountable. The idea is to give ordinary party members genuine power to supervise decision-making and choose their representatives. The party's rules already grant its 70m-odd members these rights, but in practice they are ignored.

One of the party's most trumpeted experiments is in Ya'an, a municipality of Sichuan province on the edge of the Tibetan plateau. Party members there have been allowed to select delegates to party congresses through secret ballots. Normally, candidates would be selected by higher-level party leaders with just a *pro forma* show of endorsement by ordinary members. In Ya'an, even party officials who would normally be a shoo-in for congress seats have been required to seek proper election. In at least two townships, party chiefs have lost their jobs in the last two years thanks to these new-style polls.

Ya'an has also tried to turn its local party congresses into proper supervisory bodies. Normally party congresses meet every five years to rubber-stamp decisions made by party leaders. In Ya'an, these congresses now meet at least yearly and have elected permanent committees to keep local party policies under review. And leaders now have to vote in secret on big decisions instead of just obeying the party chief. The official media have hailed Ya'an's experiments as a “breakthrough”.

In the coastal province of Jiangsu hundreds of miles to the east, ordinary party members in a rural township of Suqian municipality were allowed in April to elect their own government head. The incumbent lost by a whisker. Chinese sources say Mr Hu spoke positively of the experiment during a visit to the area.

But there are clear limits. One senior political scientist at a government-run think-tank in Beijing says he believes that in the next couple of years similar experiments are likely to be launched in many more areas of China, but in low-level party structures. He does not expect such methods to be promoted in provincial-level party organs or higher until at least the end of the next decade. Few see in Mr Hu a potential Gorbachev. In all likelihood, his own “re-election” as party chief in 2007 will be conducted in time-honoured fashion, with himself as the only candidate.

Both Mr Hu and Mr Jiang have been at pains to emphasise in the last few days that the People's Liberation Army must remain subordinate to the party. In the 1980s, suggestions emerged that the armed forces be put under state, rather than party, control. But since the crushing of the Tiananmen Square protests in 1989 such debate has been silenced. The state's Central Military Commission exists only on paper (Mr Jiang will remain its nominal chief until next March when the legislature next convenes). This demonstrates the limits of political reform. A crucial role of the armed forces, as Mr Jiang made clear in his valedictory speech, is to keep the party in power. He can retire to his villa in Shanghai knowing that this is a principle no current leader of China would be likely to challenge.

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India and America

Joining the big boys' club

Sep 23rd 2004 | DELHI
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Nuclear fall-out has a shorter half-life than India feared

AFP

Engaged

"WE'RE going to come down on those guys like a ton of bricks," blustered Bill Clinton in May 1998, when India exploded five nuclear bombs under its north-western desert. Six years on, and some of the last bricks are being lifted. Underneath, India looks unscathed and relations with America, according to a joint statement on September 21st, have "never been as close". That is not saying very much; but it does mean improving ties have survived America's ever-closer alliance with Pakistan as well as India's change of government earlier this year.

This week, India's prime minister, Manmohan Singh, was in New York, his first trip outside Asia since his Congress party won the general election in May. Traditionally, Congress has been less pro-American than is the Bharatiya Janata Party (BJP), which led the previous government. In New York, however, where Mr Singh had breakfast with President George Bush, there was little sign of any shift from the BJP's stance. India was chuffed by an announcement, just before the visit, of the lifting of more of the American sanctions imposed on India as a declared nuclear power that has not signed the Nuclear Non-Proliferation Treaty.

This was part of a process known as "New Steps in Strategic Partnership", in which America is expanding co-operation with India in civilian nuclear power, space programmes and high-technology trade, and discussing missile defences. Some of the American concessions may be largely symbolic. The Indian Space Research Organisation, for example, was removed from a list of proscribed importers. But its purchases from America will still need case-by-case approval.

Indian officials, however, were keen to portray this as evidence that America now accepts India as a serious international partner. In a new book, "Engaging India" (Brookings), Strobe Talbott, deputy secretary of state in the Clinton administration, says India hoped its nuclear test would force America to pay it "serious, sustained and respectful attention". That seems to have been achieved. Mr Talbott concedes that the diplomatic drive he led with India, to persuade it to limit the development and deployment of its nuclear arsenal, was partly a failure. But it laid the basis for the present strength of the relationship.

That strength, of course, has its limits, partly set by America's dependence on Pakistan in its war with al-Qaeda and the Taliban. In March, Indian diplomats were seething when America's secretary of state, Colin Powell, announced that Pakistan was to be one of America's "major non-NATO allies"—just after a visit to Delhi where this seemed to have slipped his mind.

India, however, has always aspired to rise above the "hyphenation" of itself and Pakistan, and quickly contrived to overlook the slight. In his book, Mr Talbott describes an abortive effort to persuade Pakistan not to reciprocate India's 1998 nuclear test. "It will not stop there," fulminated Gohar Ayub Khan, Pakistan's then foreign minister: India "will force itself into permanent membership of the UN Security Council." Certainly, that is India's hope, even if it seemed fanciful at the time. On September 22nd, along with Brazil, Germany and Japan, it launched a joint bid for membership.

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Japan

Koizumi's remaining battles

Sep 23rd 2004 | TOKYO
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Has the prime minister grown too weak to complete his political reforms?

AS BOTH leader and chief gadfly of the Liberal Democratic Party, which has ruled Japan almost continuously for a half-century, Junichiro Koizumi has always faced an awkward assignment. He took office in April 2001 promising to “change the LDP, change Japan”, and now has only two years, at most, left in his term: LDP rules dictate that he must step down in September 2006. Although he is promising an eventful two years, filled with economic reforms and foreign-policy adventures, Mr Koizumi's legacy may turn on whether he completes the political transformation that he started.

He will face crucial choices next week, when he reshuffles his cabinet along with the LDP's leadership posts. The new line-up may help to answer a fundamental question: does Mr Koizumi still have any fight left after an embarrassing showing in this summer's upper-house elections?

Many of Mr Koizumi's most important economic reforms are dear to his heart because they help to reshape the LDP's internal political landscape. Cutting public-works spending has eroded a valued source of patronage and votes for the LDP old guard. His bid to privatise the postal service, which doubles as the world's biggest bank, is worth attempting on its economic merits, but has the added advantage of derailing another LDP gravy train.

Mr Koizumi has got away with such gambits because, unlike his internal rivals, he has based his power on national appeal. The absence of any clear alternative leader to fend off the opposition Democratic Party of Japan, which now has a realistic shot at power, has also kept the LDP old guard at bay. At times, Mr Koizumi has pressed this advantage. Instead of promoting new MPs to the cabinet frequently, following an LDP conveyor-belt system that rewards long-serving members from big factions, he has mostly chosen ministers who suit his tastes, and has shuffled them infrequently.

His most heralded victories have been over the LDP's biggest political faction, the so-called Hashimoto faction, which lost eight seats in last November's lower-house election and another 11 in this summer's upper-house poll. Although those were LDP seats, the losses were hardly tragic for Mr Koizumi. His own former faction, run by the previous prime minister, Yoshiro Mori, gained as many seats as the Hashimoto faction lost. Mr Koizumi has also managed to split many factions down the middle. During the LDP leadership race a year ago, many members of rival factions backed his bid.

Mr Koizumi's LDP antagonists, however, believe that he is now in a weaker position. Unless he calls a snap election, the LDP does not have to go to the polls again during the rest of his term. His popularity has also slid. Mr Koizumi felt obliged to make a huge concession earlier this month, by agreeing to let the Hashimoto faction's upper-house leader, Mikio Aoki, nominate the two upper-house members who will serve in his next cabinet. For the most part, however, he has vowed to favour ministers who back more reform. Hopefully, he will stick to his guns: let up on the LDP, let down Japan.

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Australia

Downing Downer

Sep 23rd 2004 | ADELAIDE
From The Economist print edition

Australia's foreign minister is fighting for his political life

Get article background

EVER since his son, Joshua, was killed by a terrorist bomb in Bali in 2002, Brian Deegan has waged a campaign against the foreign policy of Australia's conservative coalition government, led by John Howard. Mr Deegan blames the government's close support for the Bush administration for making Australia a terrorist target, and the government's failure to take the threat seriously, for the deaths of his son and 201 others in the Bali attack. Now he has taken his campaign a step further by giving up his comfortable life as a magistrate in Adelaide to stand as an independent candidate against Alexander Downer, the foreign minister, in Australia's national election on October 9th.

Deegan's run

No one has written off his chances, even though Mr Downer has easily held the seat, in the affluent Adelaide Hills district, for most of the past 20 years. An exception was two elections ago, in 1998, when the Democrats, a small centre party, came close to taking it with the benefit of second-preference votes. If Mr Deegan makes a similar impact this time, it will reflect the extent to which foreign policy has become a decisive campaign issue. Mr Howard is seeking a fourth term based on his record on the economy and his handling of security in the face of terrorism.

So far, there is little to distinguish the government from the opposition Labor Party on economic policy. But on security, Mark Latham, the Labor leader, has attacked the government over its commitment of troops to Iraq and promised a foreign policy focused less on the alliance with America and more on fighting terrorism in Australia's own region. Mr Deegan supports this stand, which may be striking a chord with voters. A car bomb that killed nine people outside the Australian embassy in Jakarta, the Indonesian capital, on September 9th was a sobering reminder that Australia faces a terrorist threat close to home. Security dominated the campaign's only television debate between Mr Howard and Mr Latham three days later, in which Mr Latham declared that the Iraq venture had made Australia “less safe” in the war against terror. Mr Latham emerged a clear winner in a poll of the studio audience by 67% to Mr Howard's 33%.

Both leaders have since vied to establish their security credentials. Mr Latham has promised to spend A$300m ($210m) building an armed coast guard, integrated with the Australian federal police, to patrol Australia's northern waters between itself and Indonesia. Mr Howard would spend A$100m deploying two squads of counter-terrorism police to South-East Asia. He also resurrected a pledge that he might order a pre-emptive military strike in an overseas country to forestall a terrorist attack on Australia. Predictably, this drew objections from Australia's South-East Asian neighbours; Mr Downer was left to quell them with the somewhat lame explanation that a “failed South Pacific state” would be the most likely target.

None of this has given Mr Howard an electoral boost. A newspaper opinion poll, which earlier had both sides neck-and-neck, on September 21st showed Mr Howard's support dipping, Mr Latham's rising and Labor leading the coalition by 52% to 47%. On these trends, and with three opposition parties having offered him their second-preference votes, Mr Deegan stands a good chance of beating Mr Downer.

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Kazakhstan

Dynastic blues

Sep 23rd 2004 | ALMATY
From The Economist print edition

Trouble in the first family?

Get article background

ALTHOUGH the official results are not yet known, Kazakhstan's presidential party Otan has already claimed an overwhelming victory in Sunday's parliamentary elections. Paradoxically, this appears to have foiled, for now at least, an attempt to create the first political dynasty in modern Central Asia. Dariga Nazarbaeva, the president's daughter and founder of a new party called Asar (“All Together”), had hoped to win 50% of the votes, but seems to have got only about 11%.

Ms Nazarbaeva, 41, an accomplished opera singer, media mogul, a mother of three and a grandmother, has always denied any ambitions for the top job, which has been held by her father, Nursultan Nazarbaev, 64, for the past 15 years. Her stated goal was to shake up the team of bureaucrats that surround her father and who discredit his policies. But if her party had done better, she could conceivably have become the speaker of the Mazhilis, the lower house, and thus second in line to succeed the authoritarian president in case of his illness or resignation. This now seems unlikely.

Kazakhstan, an ex-Soviet republic of 15m, has never had anything close to a free or fair election. Not surprisingly, the Organisation for Security and Co-operation in Europe found, once again, that the September 19th elections to the 77-seat Mazhilis fell short of its standards. The three opposition parties are all complaining of falsification on a massive scale.

Yet despite the “result”, it is clear that there is growing discontent and disillusion about the high level of corruption that surrounds the country's leadership. Kazakhstan is rich in oil and has seen significant economic growth over the last five years, in many respects even surpassing Russia's. A new elite and middle class have emerged, which is now demanding political reform from the president, and a greater say in the country's development.

As for Dariga Nazarbaeva, she may either have simply failed to gain much public support or been put in her place by her father. The acting chairman of Otan, Amangeldy Yermegiyaev, shrewdly describes the father-daughter relationship with a common Russian proverb. A soldier who does not try to become a general is a bad soldier, he says, and smiles.

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Iraq

The struggle for order

Sep 23rd 2004 | BAGHDAD
From The Economist print edition

Reuters

Despite hopeful assurances from America's president and Iraq's interim prime minister, the country is not getting any safer

Get article background

IN A recent television advertisement placed by Iraq's electoral commission, which says it expects voters to start registering for January's hoped-for general election in a month or so, a cosy family of four cheerfully discusses the coming poll. All citizens, they decide, should vote: a nation is stronger when everyone joins in to build it. Opinion polls taken last month suggested that 88% of Iraqis planned to vote, against only 8% who did not.

But will they be able to? Most Iraqis say it is hard to imagine going to a polling station if car-bombs still go off regularly in the heart of Baghdad, a trip to the corner shop carries a risk of being caught in crossfire, and insurgent sympathisers are free to threaten those who want to vote with a bullet in the head.

Iyad Allawi, prime minister of the interim government, who still promises to lead Iraq to a credible election, says the rebels will be contained and the no-go zones where people will be unable to vote freely will be eradicated. If such bad spots as Fallujah, to the west of Baghdad, can be sealed off if not subdued, the rest of the country will be peaceful enough to witness a fair ballot.

But there is still no sign of the government forces, spearheaded by 140,000 American troops and 22,000 from allied countries, getting on top of the insurgents, whose estimated numbers range from 20,000, according to one American general, to twice that figure. Every day the government troops sweep the bastions of Islamist and Baathist fervour around Haifa Street, a main road in Baghdad in easy mortar range of the “green zone” where the government is seated. No sooner do the American and Iraqi troops disappear than armed guerrillas re-emerge, to badger and hector passers-by.

The kidnapping of foreigners, a practice that began in earnest only in April, shows no sign of abating. Since then, at least 137 have been nabbed, of whom 28 have been killed, 29 are still being held, and 60 have been freed or escaped, says the Brookings Institution in Washington, DC; the status of the rest is unknown. In the past week a group led by a Jordanian Islamist fanatic with proclaimed links to al-Qaeda, Abu Musab al-Zarqawi, has beheaded two American civil contractors and has threatened to do the same

to a Briton. The trio were grabbed in Baghdad's Mansour suburb, previously considered pretty secure.

Mr Allawi and the Americans stress that most of Iraq is more or less safe. Of 18 provinces, 11 are said to be calm. The three Kurdish provinces in the north-east have been quiet. A state-funded newspaper, *al-Sabah*, reports that 75 out of Iraq's 86 biggest towns are at least “semi-stable”. Most of the unstable 11 are in the Sunni triangle mainly north and west of Baghdad.

At present, the rebels control Fallujah outright. In nearby Ramadi, American patrols enter in the morning and let the insurgents take over the streets in the afternoon. In Samarra, police and local officials keep order under a deal recently brokered with tribal sheikhs, but rebels still periodically ambush American patrols. Sadr City, Baghdad's north-eastern Shia slumland, is often off-limits. But even outside the Sunni triangle conditions vary widely from town to town; the insurgency ebbs and flows. Basra, a haven of relative stability a year ago, is now less secure.

One snag, for Mr Allawi and the Americans, is that no one knows exactly who the Sunni insurgents are. Apart from a desire to throw foreigners out of Iraq, they vary in their aims and ideology, and are loosely organised. Most of their leaders are known only in their home towns or districts.

Though foreigners are thought responsible for most of the suicide-bombs that periodically cause mayhem (some 83 have gone off since the fall of Saddam Hussein, at a rate that may be slightly going down), they do not dominate the insurgency. Of 5,500 suspected rebels in prison, only 130-140 are foreigners. It is unlikely that Mr Zarqawi masterminds a national network; some intelligence sources reckon he has around 200 active disciples. But he is a symbol of defiance for a range of zealots across the country and beyond.

Even in Fallujah, several competing groups sit on a “council of mujahideen”. Some associate themselves with the Muslim Scholars' Board, a group of conservative Sunni theologians who endorse attacks on American troops but are against random street bombs and have helped free hostages. But in nearby Khaldiya, members of the “Daham network”, named after a local preacher, denounce Fallujah's scholars' board as atheistic collaborators. Even if Mr Allawi wanted to negotiate, it would be hard to seek out interlocutors.

The insurgency could spread further if the present shaky truce with Muqtada al-Sadr, a turbulent Shia cleric with strong support especially in Sadr City, breaks down. Whether or not with Mr Sadr's connivance, his Mahdi Army has failed to hand over its weapons, as the government demanded. When disarmament negotiations recently broke down, American and Iraqi troops arrested several Sadrist clerics whom they accused of hoarding guns and rocket-launchers, then marched into the movement's base in Sadr City to restore order. After two weeks of relative calm, renewed fighting left at least 20 dead. There are fears that Mr Sadr's rank-and-file might lose patience with its leader's new-found restraint—and that the hitherto cohesive Sadrist movement might disintegrate into dozens of smaller groups. That would make negotiation far harder too.

Refusing to lose heart

Mr Allawi's people insist they can reverse the trend towards insecurity. Iraqi officials say their forces are being steadily built up, with more recruits and better training and weaponry. Soon, they say, they will be able to tighten border controls to keep out foreign fighters; then they will tackle the insurgents' strongholds, even Fallujah and Sadr City.

A week ago, senior American soldiers were suggesting that voting might be cancelled in towns like Fallujah. Now, perhaps with Mr Allawi's encouragement, they are talking of retaking the town in December, putting off a showdown until after America's presidential election—and until Iraqi forces have been beefed up.

But the UN, which is supposed to oversee the election, sounds unconvinced. While it has some experienced officials at hand, it still seems to be holding back. An effective international protection force

for the UN, whose headquarters and top representatives in Baghdad were blown up last year, has yet to be mustered. The UN's secretary-general, Kofi Annan, recently doubted whether a credible election could be held in present circumstances, suggesting he would continue to keep his staff in Iraq to a minimum until Mr Allawi clearly makes headway against the rebels.

Despite the gloom, Iraqis are still surprisingly optimistic. An opinion poll a few weeks ago found that 47% reckoned life was better than under Mr Hussein, versus 31% who said it was worse; and 58% said democracy was likely to succeed, against 32% who said it would not. But responses varied hugely from area to area: Sunnis were notably gloomier on all scores.

Everywhere, plainly, security is overwhelmingly people's biggest worry. Until it improves, reconstruction will stall—and the hopes of Messrs Allawi and Bush for a decent election, enabling a strong and legitimate government to take over, will continue to look uncertain to be fulfilled.

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Iran's nuclear ambitions

Still heading for a showdown

Sep 23rd 2004
From The Economist print edition

There is little room left for diplomacy

Get article background

AP

Khatami says he can't see any nukes

“WE HAVE made our choice: yes to peaceful nuclear technology and no to nuclear weapons,” said Iran's president, Muhammad Khatami, this week. But few are convinced. Among the doubters are Britain, France and Germany, the European trio that last October thought it had the makings of a face-saving deal to head off Iran's nuclear ambitions. Since then, inspectors have turned up more evidence of past wrongdoing, and Iran has turned more belligerent.

On September 18th the 35-nation board of the International Atomic Energy Agency (IAEA), the UN's watchdog, called for a full accounting of Iran's nuclear programme when next it meets, in November. Miffed Iranian officials suggest that they may end co-operation with the agency. Iran's parliament refuses to ratify an agreement for intrusive inspections. And it could drop out altogether from the Nuclear Non-Proliferation Treaty (as North Korea did in 2003), say the officials, if the IAEA board sends its case to the UN Security Council and sanctions follow.

The United States has been pressing for just such a referral for more than a year, ever since inspectors, acting on a tip-off from an exiled opposition group, uncovered an almost 20-year trail of covert nuclear research involving uranium and plutonium (both potential ingredients for a bomb). Under last October's deal with the European three, Iran had agreed temporarily to suspend all uranium-enrichment-related activity while inspections continued; the hope was that, with the incentive of trade in other less dangerous technologies, the suspension could be turned into a ban.

But Iran has steadily back-tracked. This week, despite a request from the IAEA's board, and a personal plea from its director-general, Mohamed ElBaradei, Iran's Atomic Energy Agency chief revealed that work was already under way to convert 37 tonnes of uranium ore into gas that could later be fed into fast-spinning centrifuge machines to produce enriched uranium—enough for several bombs, if diverted to military use.

Unless Iran has a change of heart, that activity and its continued failure convincingly to fill in some of the gaps in its nuclear story seem likely to lead to a showdown at the IAEA in November. The one hope, says Gary Samore of the International Institute for Strategic Studies in London, is that, despite its bravado, Iran still seems keen to avoid being reported to the Security Council. Yet it also seems determined to hang on to a nuclear option. Can diplomacy alone press it to choose?

Not if Iran assumes it can win in November. It knows that some IAEA members, notably Brazil and South Africa, are loth to see it pressed too hard over the enrichment suspension, since their nuclear industry relies on similar technologies. If inspectors come up with no additional proof of wrong-doing, and if Iran promises to put off actual enrichment for the time being (and especially if there is as well a change of administration in America), it may hope to avoid harsh censure. Yet Britain and France have told Iran privately that it must fulfil all IAEA requirements, including its original promise of a full suspension of all enrichment-related activity. If it does, a new window will open for diplomacy—though it is unlikely to stay open long.

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Egypt

At last, a breath of fresh air

Sep 23rd 2004 | CAIRO
From The Economist print edition

The president's modern-minded son is on the rise

FOR a generation or more, Egyptian governments have loudly proclaimed their commitment to economic and political freedom. Yet while the country is no longer quite the stiflingly socialist, totalitarian state it once was, momentum for change has fizzled out as the years of stolid rule under Hosni Mubarak stretch towards a quarter of a century. So it comes as a jolt to find his government suddenly doing tangible things to shake up the economy, and to see the country's haplessly shrill and fractious opposition actually unite behind a realistic platform for political reform.

Earlier this month the government slashed Egypt's high tariffs and abruptly cleared away a mass of rules that have long made its bloated customs service a breeding ground for corruption. This week, Egyptians woke to the news, announced at the ruling National Democratic Party's annual conference, that both income and corporate taxes are to be halved, with top rates capped at 20%. Officials also vow to speed up privatisation, reform the state-dominated banking system, and, in the words of one minister, “change the whole mindset of how we work”.

Inured to empty rhetoric, Egypt's 70m people are not easily impressed. But when the cost of an imported car falls by $5,000 and their take-home pay goes up by a fifth, they will notice, especially after several years of slowing economic growth, rising unemployment and falling living standards. Moreover, key people implementing the changes are relatively young, fresh and earnest. Most, in fact, are protégés of the president's 41-year-old son Gamal.

For the past four years, the younger Mubarak, a former banker, has tried to breathe new life into the dowdy ruling party, which controls 85% of the seats in Egypt's rubber-stamp parliament. His efforts, as head of a policy-planning committee, were stymied until recently by the lingering influence of control-obsessed heavyweights from his father's generation. Following a brief illness in June that seems to have refocused his thoughts on the future, however, the 76-year-old elder Mubarak appointed a new prime minister, sacked several ministerial stalwarts, and brought in a new economic team. The government and party now project a far clearer vision, reflecting Gamal Mubarak's own wish for greater integration with the global economy—and to the delight of Egypt's beleaguered business people.

Yet ironically it is the rise of the younger Mubarak that is galvanising an opposition movement that has long been rendered futile by government restrictions, as well as by sniping between leftists, rightists, secularists and Islamists. President Mubarak's current term expires next autumn. Despite repeated official denials, many Egyptians suspect that Gamal will be promoted to succeed him, and object to the notion of hereditary rule. Nor is there much enthusiasm for the only presently evident alternative, which is that the elder Mubarak should seek a fifth six-year term.

Under Egypt's 1971 constitution, presidents are not directly elected but chosen by at least two-thirds of MPs, then confirmed by referendum: essentially, no contest. With a single voice, the opposition now demands direct, contested elections, the abolition of laws that shackle political life and allow for arbitrary arrest, and constitutional reform to redress the current, extreme imbalance between the executive and other branches of government. Weak as it is, the opposition may at last have found a set of issues to shake the Egyptian public out of its legendary apathy.

For the time being, the government is not listening. The funny thing is that if it did listen, by this time next year, presumably sated with their tax-cut cash and cheaper consumer goods, Egyptians might actually vote for Gamal Mubarak.

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Women in the Gulf

Riding ahead

Sep 23rd 2004 | DUBAI
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Some Arab royal families are giving their women a longer leash

THE royal families of the Gulf are not renowned for empowering women. But Dubai's ruling Maktoum family has taken some notable strides down that path. No fewer than three of its women have recently made once-unthinkable public appearances in international sports events.

Princess Haya of Jordan, the beautiful new wife of Dubai's crown prince, Sheikh Mohammed, led the way with pictures of herself in Dubai's newspapers after winning a horse race in Britain. The 30-year-old Oxford graduate was pictured in full riding gear receiving the trophy for the 160km (100-mile) Thetford Forest endurance ride. This was a telling break from tradition: there is no known public image of the sheikh's first official wife, Sheikha Hind.

Princess Haya is no stranger to publicity: she rode for Jordan in the Olympics in 2000. More interestingly, this new openness is being extended to blood members of the Maktoum family. A few days before Princess Haya's victory, Sheikha Madiya bint Hasher al-Maktoum became the first woman from the United Arab Emirates (of which Dubai is one of seven) to compete in an endurance horse race when she finished 25th in an event in the American state of Idaho. In the same week, Sheikha Maitha bint Mohammed bin Rashid al-Maktoum (the ruling sheikh's daughter by Sheikha Hind) won four gold medals at the Gulf karate championships.

Such appearances highlight the emergence of women in society, business and even politics in the long-conservative Gulf states. In the more liberal—such as Dubai, Bahrain and Kuwait—local and foreign women have been landing big corporate jobs for several years. Female Arab executives from such companies as Hewlett-Packard and, significantly, Saudi Aramco, the kingdom's state oil company, are soon to attend a “Women in Leadership” conference in Dubai.

Arab women have won limited political rights in Qatar, Bahrain and Oman. Sheikha Moza, wife of Qatar's emir, is a much-praised standard-bearer of women's rights. She is the force behind, among other projects, Qatar's Carnegie Mellon University, which opened this month, unprecedentedly with mixed male and female classes. Three-quarters of the new intake are female.

But female emancipation still has its limits. Dubai newspapers published no pictures of Sheikhas Maitha and Madiya, despite their courage in the public arena. Women still cannot drive in neighbouring Saudi Arabia, and are unlikely to be able to vote in the forthcoming local elections. The vote in Kuwait is also restricted to men. The United Arab Emirates steadfastly resists all moves towards democracy, and royal succession remains, so far, an entirely male affair.

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Libya

Back in the fold

Sep 23rd 2004 | CAIRO
From The Economist print edition

With America's economic sanctions lifted, Libya is a juicy market again

MANY small countries would be glad to land a windfall of $1.3 billion. Not Libya. The oil exporter holds some $20 billion in foreign-exchange reserves anyway. Besides, the windfall comes from Libya's own money, frozen in American banks since the United States imposed sanctions on Libya back in 1986, and released this week by President George Bush's administration. More to the point, most of that $1.3 billion has already been earmarked to pay damages to the 259 victims in the Pan-Am airliner that was blown up in 1988 over the Scottish town of Lockerbie, a crime for which the Libyan government has admitted responsibility.

Even if Libyans will not see their money, its release is welcome. It comes as part of the latest parcel of international rewards the country has earned through a decade-long effort to shed the roguish image its government gained in the 1970s and 1980s. It is several years since the United Nations dropped the mild sanctions it imposed as punishment for Lockerbie. America retained a tougher embargo of its own but suspended it last April, after Libya had decided to reveal all its weapons-development programmes—and to scrap them. The European Union is to drop its economic and arms-trading sanctions too.

This week, the Americans officially lifted their sanctions for good, freeing the frozen funds and removing blocks on trade and investment. American law still bans the sale of American arms, as well as some aviation and communications gear, but this is because Libya happens to remain on a list of countries deemed to be “state sponsors” of terrorism. According to the Lockerbie compensation agreement, Libya, which has already paid one tranche of indemnities, will pay a final instalment once it is removed from this list. It would probably have been taken off it already, were it not for evidence that its agents may recently have been involved in a bizarre plot to assassinate Saudi Arabia's Crown Prince Abdullah.

If Libya's 5m ordinary citizens are glad to have past stigmas rubbed out, so are the American companies that developed and long dominated the country's oil industry. Though little of Libya's territory has been seriously explored, its reserves are already reckoned to be Africa's largest. They lie close to western markets and far from the strife-prone Gulf. Libyan oil is also sweet, meaning easy to refine, as well as cheap to produce. Extraction costs of $1 a barrel are pretty enticing, when consumers pay 45 times as much for a barrel of crude.

Libya's government says it wants to raise oil output by half in three years, and eventually to double it. It reckons it needs to invest $30 billion to do this, as well as to develop the country's big gas reserves. Not surprisingly, scores of foreign firms are poised to take part in the current round of bidding for Libyan concessions, the first in four years. But it may take more than capitalist greed to erase memories of Libyan past piracy or to shrug off the present experience of the country's bumbling, grasping and erratic bureaucracy.

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Southern Africa's land

Dish it out!

Sep 23rd 2004 | JOHANNESBURG
From The Economist print edition

A new report frets about blood and soil

“WHAT'S cooking in Zimbabwe is a wake-up call for South Africa,” says Peter Kagwanja, a Kenyan who runs the southern African branch of the International Crisis Group (ICG), a think-tank based in Brussels. Zimbabwe botched land reform, partly by letting whites keep the best farms for too long, thereby making them easy targets for a demagogue, Robert Mugabe. South Africa, says the ICG in a report just out, runs the same risk. A few thousand whites still own about 85% of the farmland, barely less than in 1994, when a mainly black government came to power. Such inequality is bound to lead to anger and instability, says the ICG.

South Africa's government has some sensible plans for shifting land ownership but has spent little of the required money. Unless it were to resort to mass confiscation à la Mugabe, it has virtually no hope of doubling black ownership of the land to 30% by 2015, as it promises. Violence against white farmers, including murder, continues apace: the commercial farmers' union says 388 of them have been killed since 2001, 54 this year. White farms are still occasionally invaded. South Africa looks stable now, says Mr Kagwanja, but for the first ten years or so after independence so did Zimbabwe.

South Africa, in any case, is doing a bit better. Since 1994 some 3.2m hectares (7.9m acres) of farmland, 2% of the total, has passed into black hands. It has been a slow business: new land-ownership laws had to be passed first. But things should now speed up. The constitution guarantees full compensation for owners. The police have usually managed to chase away those who have invaded white farms.

The ICG may overdo the dangers. If frustration over land ownership did boil over, the impact on South Africa would be weaker. Its economy, unlike Zimbabwe's, long ago stopped depending on agriculture, which accounts for only 3.4% of GDP and provides only a tenth of South Africa's people with a living. The rural poor rely more on welfare or remittances. A South African demagogue would do better whipping up anger over the lack of urban jobs, not over farmland.

The ICG's glum warnings are more relevant to Namibia, where a populist president, Sam Nujoma, who admires Mr Mugabe, is threatening to grab big farms from some whites—“snakes” who, he says, mistreat their black workers. Namibia's economy is dominated, as was Zimbabwe's, by white-owned farms. While promising whites compensation, Mr Nujoma wants to boost his ruling party before a general election in November, when he is due to step aside in favour of Hifikepunye Pohamba, his ageing minister for land.

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German politics

Angela, Gerhard and the neo-Nazis

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From The Economist print edition

AFP

How the fall-out from two state elections in eastern Germany could turn out to benefit Gerhard Schröder

BAD news from Germany has not exactly been in short supply recently: slow growth, high unemployment, mass protest rallies, a weakened government. Perhaps the only element missing from the list was a comeback by the far right. And this duly came on September 19th, in elections in Brandenburg and Saxony.

The results were shocking, especially in Saxony, where the neo-Nazi National Democratic Party (NPD) took 9.2% of the votes, almost as much as the Social Democrats (SPD), and secured 12 seats, the first time in 36 years that it has got into any state's parliament. Meanwhile in neighbouring Brandenburg, another far-right party, the German People's Union (DVU), took 6.1% of the vote.

The vote for the far right reflects more than just a protest by those disillusioned with the results of unification. These parties have developed an enduring appeal. Far-right voters are often unemployed young men without a high-school diploma. In Saxony some 21% of 18-29-year-olds voted for the NPD. And the parties are becoming more professional. NPD leaders in Saxony are not easily identifiable extremists, but come from the mainstream: among their future members of the state's parliament are the owner of a driving school, a doctor and a journalist. They have built a proper party organisation and even cut a deal not to oppose the DVU in Brandenburg if the DVU does not run in Saxony. Now the two parties are striving for a joint electoral list of all far-right parties at the federal election in 2006.

Yet it remains doubtful whether the far right can repeat this week's success in the west. Far-right parties have done even better in the past, only to self-destruct, not least because of in-fighting. A press conference at which some of the party's new members of parliament were denied the microphone suggests that the NPD may not do any better in Saxony.

The bigger conclusion from these state elections is that the two main parties are being punished. This was expected in the case of the SPD, which is in government and has pushed through structural reforms. In fact, it did better than it had feared in Brandenburg, where it remained the strongest political force with 31.9%, edging out the ex-communist PDS, which had been hoping to take the top spot.

More surprising were the losses by the Christian Democrats (CDU), particularly in Saxony, where they shed 16 points, to win only 41.1%. That meant losing their absolute majority for the first time since 1990, which may force the CDU to form what some call “a coalition of the losers” with the SPD, which took just 9.8% of the votes, its worst showing in any state election since the second world war.

Although both elections were in eastern states, the CDU's suffering has changed the whole dynamic of German politics. All of a sudden, it no longer seems so obvious that the CDU will win the election in 2006, nor even the state of North-Rhine Westphalia in May 2005 (see article). It is also no longer so certain that Angela Merkel, the party's boss, will be its candidate for chancellor, nor that its programme will be as radical as she would like.

Angela's ashes

This is quite a reversal of fortunes for Ms Merkel. Against many predictions to the contrary, she has managed to fashion herself, over the past 12 months, as a reformer in the mould of Britain's Margaret Thatcher. She has also pushed aside all her male rivals within the conservative opposition parties, including Edmund Stoiber, the premier of Bavaria, who narrowly lost to Mr Schröder at the 2002 general election. Now, even as she tries to mirror Maggie, Ms Merkel faces a challenge more like the one faced by Britain's Tony Blair with the British Labour Party ten years ago: how to give the CDU, which more reform-minded leaders have been bitterly calling Germany's “second Social Democratic Party”, a serious makeover before it gets closer to taking power.

So far, she has been less successful at this second task, thanks not least to resistance from the CDU's sister party in Bavaria, the Christian Social Union (CSU), led by Mr Stoiber. Mr Stoiber still harbours hopes of a second chance against Mr Schröder. And it is the centrepiece of Ms Merkel's reform plans that sticks in the CSU's craw: her plan for a flat-fee health premium, which opponents see as a poll tax for health.

The CDU's poor showing in Brandenburg and Saxony will not make it any easier to hammer out a compromise with the CSU on health. Ms Merkel is turning up the heat. The CSU wants to slow things down, using the argument that “quality goes before speed”. Ms Merkel and Mr Stoiber plan to meet next week to try to resolve their differences.

In contrast, Mr Schröder looks surprisingly relaxed. For the outcome in Brandenburg suggests that the SPD can win elections (or at least not lose them so badly) when it defends its reforms, as Matthias Platzeck, the state's premier, did. And the more the conservatives quarrel, the more Mr Schröder seems the only politician who can stand up for his beliefs—even if this means that his party goes down in flames in 2006.

Mr Schröder may also take comfort from signs that his reforms are starting to work. Statutory health insurers are profitable again, and more long-term unemployed people appear to be seriously looking for a job, even though his tough new benefit rules will not go into effect until January 2005. And the general mood is shifting. There is growing annoyance with the “high-falutin' whining” to which Germans often default. The press has begun running stories arguing that not all is rotten in the state of Germany, and that many things have changed for the better. What is more, weekly protests against labour-market reforms are losing momentum.

Mr Schröder will still have to fight (and will probably lose) a long battle for his political survival. For that reason, he is unlikely to tackle further painful but necessary reforms. Yet, even if a sizeable minority of Germans are now voting for extremist parties at both ends of the political spectrum, most are starting to understand that, if Germany is to keep its cherished welfare state, it needs seriously to modernise it.

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North-Rhine Westphalia

Boomtown bust

Sep 23rd 2004 | HERNE
From The Economist print edition

The Social Democratic Party under threat in its heartland

DESPITE Germany's large Turkish population, an increasing number of whom now vote, politicians do not often campaign in mosques. But Horst Schiereck, the Social Democrat (SPD) candidate for mayor of Herne, in the Ruhr, needs every vote he can get to fend off his Christian Democrat (CDU) rival, Markus Schlüter.

It would be a disaster for the SPD if it lost this city in municipal elections in North Rhine-Westphalia on September 26th. Staying in power after the crucial state election next May might then look impossible. Conversely, if the party could improve on its poor performance of five years ago, the CDU leader, Angela Merkel, would be in trouble, for it would look a lot less likely that, after next May, she could turn the SPD's Gerhard Schröder into a lame-duck chancellor.

Herne, where the SPD once counted on over two-thirds of the vote but is now down to one-third, is a typical example of what happens when a party is in power for too long and is suffering from the unpopularity of the government in Berlin. But it is also a city that is, in some ways, even worse off than comparable places in eastern Germany.

Take a stroll down Bahnhofstrasse, the main street, and it is hard not to think that it has seen better days. Having survived the Allied bombs, Herne became one of the Ruhr's boom towns after the war. But in the 1960s, the decline of heavy industry meant that this city, with a population of 170,000, shed more than 40,000 jobs. Although some new jobs were created, particularly in services, Herne never really recovered. Unemployment is stuck at 15%. The economy is the main theme of the mayoral campaign. Mr Schiereck promises to do more for smaller firms; Mr Schlüter talks of creating a “feel-good environment for business”.

Whatever these pledges might mean in practice, Herne is unlikely to get out of its slump without some outside help, because it does not have the money. The city's best bet is that municipalities in the Ruhr co-operate more—and perhaps, one day, even fuse into a single city. On October 1st will come a first step: the creation of a new regional body.

Yet even if Herne became part of a larger entity, it would still need a better vision of itself. Some have suggested it should turn its large foreign population (over 12% of the total) into an asset. It might become the city in the Ruhr that caters best to foreigners' needs, by helping, say, young Turks to start businesses. One day, Herne's mayor might himself be of Turkish descent.

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Turkey and the EU

Will Turkey accept Europe?

Sep 23rd 2004 | ANKARA
From The Economist print edition

A bad-tempered argument breaks out over values

AP

Erdogan errs into Europe

AFTER 40 years of hesitation, the leaders of the European Union had been girding themselves for a fateful decision in December: to start membership talks with Turkey, and thus to accept the likelihood that, in a decade or two, the EU's most populous member state will be Muslim. But is Turkey ready to accept the EU's values?

As relations between Turkey and the EU went into a tail-spin this week, the answer to that question began to look more doubtful. Recep Tayyip Erdogan, Turkey's moderate Islamist prime minister, flew to Brussels on September 23rd to defuse a crisis that he himself had triggered, when he suddenly withdrew a long-planned package of amendments to Turkey's penal code. He even suggested that he wanted to revive the criminal penalties for adultery that his government had earlier seemed prepared to drop.

Yet both Mr Erdogan and the European Commission (which on October 6th must deliver its opinion on Turkey's eligibility for the Union) had a strong interest in avoiding a complete derailment. Turkey's parliamentary speaker has acceded to opposition demands for an emergency session, likely to be held on September 26th, at which the new penal code should be adopted. After his talks with Mr Erdogan in Brussels, Günter Verheugen, the European commissioner in charge of enlargement, declared that “no outstanding obstacles remained on the table.”

Even if the immediate row over the penal code is resolved, advocates of Turkey's EU membership have had a shock—their biggest since 1997, when a brush-off from EU leaders provoked fury in Ankara. Mr Verheugen called the proposal to re-criminalise adultery a “joke”. Not a very funny one, either: as he warned Mr Erdogan, it served to provide ammunition for those who want to keep his country out of Europe, by giving the impression that it might want to introduce Islamic rules.

On September 17th, when the squabble was at its height, a defiant Mr Erdogan told the Europeans to mind their own business. In a still odder change of rhetoric, he even insisted that “EU membership is not the be-all and end-all.” The financial markets told a different story. The value of the Turkish lira took a pounding, as did the main index of the Istanbul stock exchange.

Does Turkey really have an alternative to closer ties with Europe? Relations with the country's most powerful ally, the United States, have been overshadowed by differences over Iraq. Links with Israel, another important friend, have also been under strain, with Mr Erdogan making sharp attacks on Israeli treatment of the Palestinians. Some Turks dream of new relationships with Iran, Syria or Russia—but these countries have a history of backing Turkey's internal trouble-makers, from Kurdish separatists to Islamists.

Unless it was a cunning political feint, Mr Erdogan's anti-EU outburst is thus hard to understand. Some officials say the damage inflicted by Mr Erdogan's wobbly behaviour will be hard to repair. European heavyweights such as Germany's Chancellor Gerhard Schröder and France's President Jacques Chirac have incurred political costs at home by backing the plan to open membership talks with Turkey. They are said to be furious over the Turkish prime minister's erratic line.

Even before the latest row, the camp of naysayers, who are opposed in principle rather than on specific grounds to Turkey's EU membership, was gathering strength. For example, Frits Bolkestein, the single-

market commissioner and a former leader of the Dutch liberals, said in a speech earlier this month that the Union could “implode” if the Turks were allowed to join. If they did gain entry, he added, Ukraine and Belarus—which were “more European”—should be let in as well.

Given Mr Erdogan's reputation as a savvy politician, there is puzzlement in Ankara over why he shifted his ground on the penal code so abruptly. Conventional wisdom says that he was acting under pressure from conservatives in his Justice and Development party, who are disgruntled by his failure to deliver on other issues. In particular, he has failed to keep pre-election promises to ease bans on the Islamic headscarf in state schools and offices; and to enable graduates of religious schools to enter secular universities.

One Machiavellian school of thought has it that the row over adultery was part of a devious plan to focus European attention on the penal code—and away from even thornier issues such as the discrimination still faced by Turkey's non-Muslim minorities, and the ban on theological training for Orthodox Christians. But there is another, simpler explanation: as a devout Muslim, Mr Erdogan may sincerely believe the behaviour of straying spouses should be a matter for the law, and not simply for private morality.

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French economy

Sarkozy triumphant

Sep 23rd 2004 | PARIS
From The Economist print edition

A pick-up in the French economy rescues the public finances

AFTER three years in disgrace, could France at last be turning into a model economic pupil? That, on paper at least, was the message of the 2005 budget, unveiled this week by Nicolas Sarkozy, the centre-right finance minister. The government's budget deficit, he promised, will next year fall below the European Union stability pact's ceiling of 3% of GDP, for the first time since 2001. And the French economy is now growing faster than that of any other big euro-area country.

Presenting his first (and last) budget before he quits the government to take over as head of the ruling UMP party, Mr Sarkozy was triumphant. He had vowed to show that France would keep its word on controlling public finances. Sure enough, he forecast a deficit of 2.9%, thanks to a combination of better-than-expected tax receipts, frozen government spending, and a one-off payment of some €7 billion ($8.5 billion) from Electricité de France, the energy utility. This spared him the painful necessity of making deep spending cuts to meet his pledge—he will leave that task to his successor next year. Indeed, extra money was found for research, defence and “social cohesion”.

The economy has come to Mr Sarkozy's rescue. Last year's budget was based on a growth forecast of 1.7% for 2004. Now, the government expects 2.5% growth both this year and next. It could even be stronger. Year-on-year growth in the second quarter of 2004 reached a robust 3%—compared with a euro-area average of only 2%. The OECD this week revised upwards its forecast for French GDP growth this year, from 2% to 2.7%.

This has not only helped Mr Sarkozy to reduce government debt, but also to cut taxes. Not income tax: he was too responsible “as the guardian of the fruits of French people's hard work”, he stressed, to cut taxes recklessly, given the scale of the public debt. All the same, as part of a €2 billion fiscal package, he abolished inheritance tax on estates worth €100,000 or less; increased by 50% the tax relief for those with domestic employees; suspended a 3% corporate surtax; and established tax breaks to discourage industrial *délocalisation*, a buzz-word signifying the movement of jobs to low-cost locations, notably in central Europe.

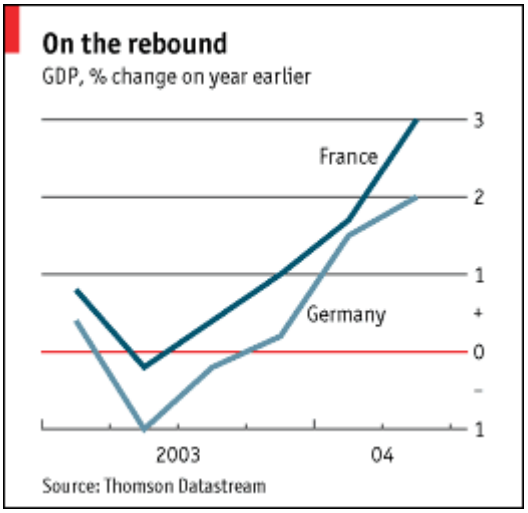
The left immediately denounced the package as a give-away for the rich. But Mr Sarkozy insisted that it would reward families for hard work, encourage job creation, and also put more money in people's pockets.

The surprising feature of France's recent economic upturn is that it has been entirely demand-driven. Exports are growing, but more slowly than imports. Investment, on the other hand, is picking up. Above all, consumers are spending heavily. In August, household spending on durable goods was up by 7% on the previous year, after a year-on-year rise of 6% in the second quarter. Indeed, France's household-savings rate could fall this year to 14%, from 17% in 2002.

Mr Sarkozy wants to sustain this by boosting purchasing power. Hence, for instance, his 4% increase in the “employment bonus”, a tax credit for working, in 2005; a 5.4% rise in the minimum wage; and a tax incentive, already in place, to encourage grandparents to pass money to adult grandchildren.

So is greater confidence prompting all this consumer demand? Not at all. Household surveys show that confidence has been flat all year. Nor does job growth offer an explanation. Unemployment has been at 9.8% for over a year. Fears of losing

jobs to low-cost central Europe are widespread, and signs of recruitment are strikingly scarce—Renault made headlines by announcing that it will hire 5,000 new workers in France next year. The buoyant housing market might be helping (average house prices have risen by 14.5% over the past year), yet it matters less in France than in Britain. “It is not as if the French are suddenly smiling about the future,” says Eric Chaney, head of European economics at Morgan Stanley in Paris. “They are simply starting to unwind an accumulation of savings that had reached an excess level.”



France's political leaders are certainly not benefiting from the consumer-led upturn. The French remain disillusioned with both a distant President Jacques Chirac—in New York this week to lecture on how to solve world poverty—and his enfeebled prime minister, Jean-Pierre Raffarin. According to a poll by Ifop, satisfaction with each fell a full six points in September: to 43% for Mr Chirac, and a miserable 31% for Mr Raffarin.

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Russia and the West

The end of the affair?

Sep 23rd 2004 | MOSCOW
From The Economist print edition

Russia's relations with the West are deteriorating

THE strategy was reminiscent of the response to the *Kursk* submarine disaster: minimise the damage, resist scrutiny, blame the West. Addressing the nation after the Beslan massacre, President Vladimir Putin conjured up a spectre of manipulative foreign powers exploiting terrorism to weaken Russia. Several Europeans and Americans have since criticised Mr Putin over Chechnya, and over his grab for more power. Mr Putin's fraternal response to September 11th had persuaded optimists that the dream of bringing Russia closer to the West might be realised. In the past two weeks, it has looked as chimerical as ever.

The Russians are used to moans from soft Europeans; from the Americans they expect harder-headed pragmatism. So it rankled when President George Bush expressed “concern” over Mr Putin's planned changes to Russia's electoral system and regional government. Sergei Lavrov, Russia's foreign minister, had earlier remarked acidly that his country did not comment on American presidential elections. Mr Putin likened those who advocated negotiating with the Chechens to 1930s appeasers. A British diplomat was called in to account for Britain's failure to extradite Akhmed Zakayev, an aide to Chechnya's one-time elected president, Aslan Maskhadov. (Shamil Basayev, Russia's other most-wanted man, has claimed responsibility for Beslan, but denied taking cash from Osama bin Laden.)

Some Russian liberals see this contretemps as a foreign-policy turning-point. Just as Mr Putin has revealed himself as an insatiable centraliser at home, he is emerging as an incorrigible great-power nationalist abroad. According to this view, Mr Putin still sees Russia's interests in terms of spheres of influence. Worse, the “Russian” values that Mr Putin espouses in such matters as human rights and strong government make closer integration with the West impossible. For the past couple of years Russia had seemed to be pursuing a “normal” foreign policy, but in reality it was detente in another guise. In future, the argument runs, mutual suspicion will co-exist with Russia's westward energy sales, just as in the last years of the Soviet Union.

If Mr Putin wants to fall out further with the West, he has chances aplenty coming up. Russia's dealings with the Europeans will be more painful now that the EU has taken in several ex-communist countries. Political consultants have been dispatched from Moscow to Ukraine ahead of next month's presidential election. Viktor Yushchenko, the Europe-friendly opposition candidate whom the Russians want to stop, resumed campaigning this week after suffering, say his supporters, an assassination attempt by poisoning. Mr Putin may also be more tolerant than the Europeans of Alexander Lukashenka's efforts to change the constitution of Belarus and stay on as its president—not least, fear Russia's liberals, because Mr Putin would like to follow suit.

Mr Putin may also alienate the West by making good on his threats to launch pre-emptive strikes against terrorists abroad—notably in Georgia's Pankisi gorge, the alleged hideaway of Chechen rebels. Russia ought to have reason to cultivate stability on its southern border. Yet it is still meddling in Abkhazia and South Ossetia, two breakaway regions of Georgia.

Reuters

Human-rights monitoring in Chechnya

A happier interpretation of recent events, pushed by Kremlin sympathisers, is that Mr Putin and Mr Bush, at least, are playing to their domestic galleries. Mr Bush managed a few remarks in response to accusations that he was doing too little to encourage Russian democracy. Mr Putin's xenophobia, and his evident nostalgia for the Soviet Union, are designed to deflect the blame for Beslan and to pacify influential hardliners. Underneath, this interpretation has it, the two presidents still understand each other and get along fine.

The truth probably lies somewhere in between. Russia's relations with the West are not as bad as they sometimes were in the volatile Yeltsin years. Mr Putin picks his fights carefully: witness his relative equanimity over NATO's eastward expansion. He may refrain from provocations in Georgia. But he is certainly no internationalist. All parties feel short-changed by their experience of the past few years: the Europeans over Russia's human-rights and democratic failings; the Americans over Iraq; Mr Putin over meddling and misunderstandings on terrorism. A new period of great-power rivalry may be far off; but Russia's closer integration with the West is probably even more remote.

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Charlemagne

Battling for brains

Sep 23rd 2004
From The Economist print edition

The parlous state of European universities

NO EUROPEAN summit can conclude nowadays without talking up plans to make Europe the most competitive “knowledge-based” economy in the world. EU leaders' fondness for this notion, first expressed in Lisbon four years ago, is understandable. Asians pay themselves less than Europeans, and Americans work longer hours—what option is left for the old continent but to rely on its intellectual resources?

There is one big snag, however. One of Europe's primary intellectual resources, its university system, is in terrible shape. Just how terrible was underlined in the recent annual survey by Shanghai's Jiao Tong University of the world's universities. This ranking gave eight of the top ten places to American institutions, with only Oxford and Cambridge breaking the American monopoly. You had to get down to 39th before an EU university outside Britain (the University of Utrecht) featured.

Many of Europe's best brains have been migrating to America to work on the world's best campuses. A survey conducted for the European Commission in 2003 estimated that 400,000 EU-born scientific researchers are working in the United States; and three out of four have no plans to return. Academics who emigrate to America find that they are in a system that seems awash with money, in comparison with Europe's. The United States spends 2.7% of GDP on its universities, according to the latest OECD figures; in France and Britain the figure is 1.1%, in Germany only 1%. A full professor at a top British university gets around £45,000 ($80,000) a year; his equivalent at an American Ivy League college can expect twice as much, and a lot more if he is a big name. Research projects are also more lavishly funded in America. The consequences for Europe's “knowledge economy” are grim. The EU produces a quarter as many patents per million people as does the United States.

The financial problems of European universities stem from their near-total reliance on the public purse. Of the 1% of GDP that Germany spends on higher education, only 0.1% comes from the private sector. Students do not pay fees in France and Germany or in most other EU countries. State funding to universities is mean and under pressure. In Britain, where student fees have been brought in, they are hugely controversial, although they are nowhere near covering the real cost of a student's education. The result is not just that universities are starved of cash, but that students often dawdle pointlessly over their courses.

Michael Burda, an economics professor at Humboldt University in Berlin, says that, because his students are not paying personally, many “just use university as a way of filling in time.” Lecture halls are crammed and the average student in his department takes 5.5 years to complete a first degree. Many European universities now look for alternative sources of funding—whether bequests from alumni or business sponsorship—but the process is far less developed than in the United States.

State control has other pernicious effects. Colleges in France and Germany do not control their admissions policies; their students are largely allocated to them by the state. This makes it harder to develop elite institutions. Even in Britain, the top universities are under huge pressure from the government to make their admissions policies less “elitist”.

Many governments across Europe have sworn to do something about the parlous state of their universities. The British have imposed tuition fees and the Italians have tried to reduce security of tenure for academics, to make them more accountable. The German government has promised to create ten elite universities. It wants to revive the scientific traditions of the first third of the 20th century, when German scientists carried off 25 Nobel prizes in chemistry and physics alone, and German science-based industries led the world. But Mr Burda dismisses the plan as “smoke and mirrors”, complaining that it has

been eviscerated by politicians and that the new money that has been promised is “peanuts”.

Self-inflicted wounds

Europe's universities cannot, on present form, look to their own governments to save them. But they may have inadvertently been given a lifeline by the American government. Post-September 11th paranoia has made it increasingly hard for foreign students to get a visa to enter the United States. Robert Gates, a former director of the CIA who is now president of Texas A&M University, wrote recently in the *International Herald Tribune* that applications by foreign students to his institution had fallen by 38% on last year. He said applications from China to all American universities had fallen by 76%, and those from India had fallen by 58%. And he argued that this would have a direct effect on America's scientific pre-eminence, since “the research efforts at many American universities depend on international graduate students. They do much of the laboratory work that leads to new discoveries.”

If America, which has traditionally had first pick of the world's top talent, is now turning much of it away, the opportunity for European institutions is clear. The number of foreign students from outside Europe rose by 60% in British universities between 1997 and 2003, driven mainly by an increase in Chinese students. Institutions in the rest of the EU are getting in on the act. An increasing number are teaching courses in English so that they can capitalise on the flow of foreign students.

But Europe's opportunity to pull in the world's talent may be fleeting. Other countries, such as Australia, New Zealand and even Japan, are competing harder for overseas students. Britain's share of the overseas-student market has dropped. And protests from universities in the United States may persuade the American government to relax its approach to foreign students. It may prove easier to fix America's visa policy than to cure the deeper-seated problems of Europe's universities.

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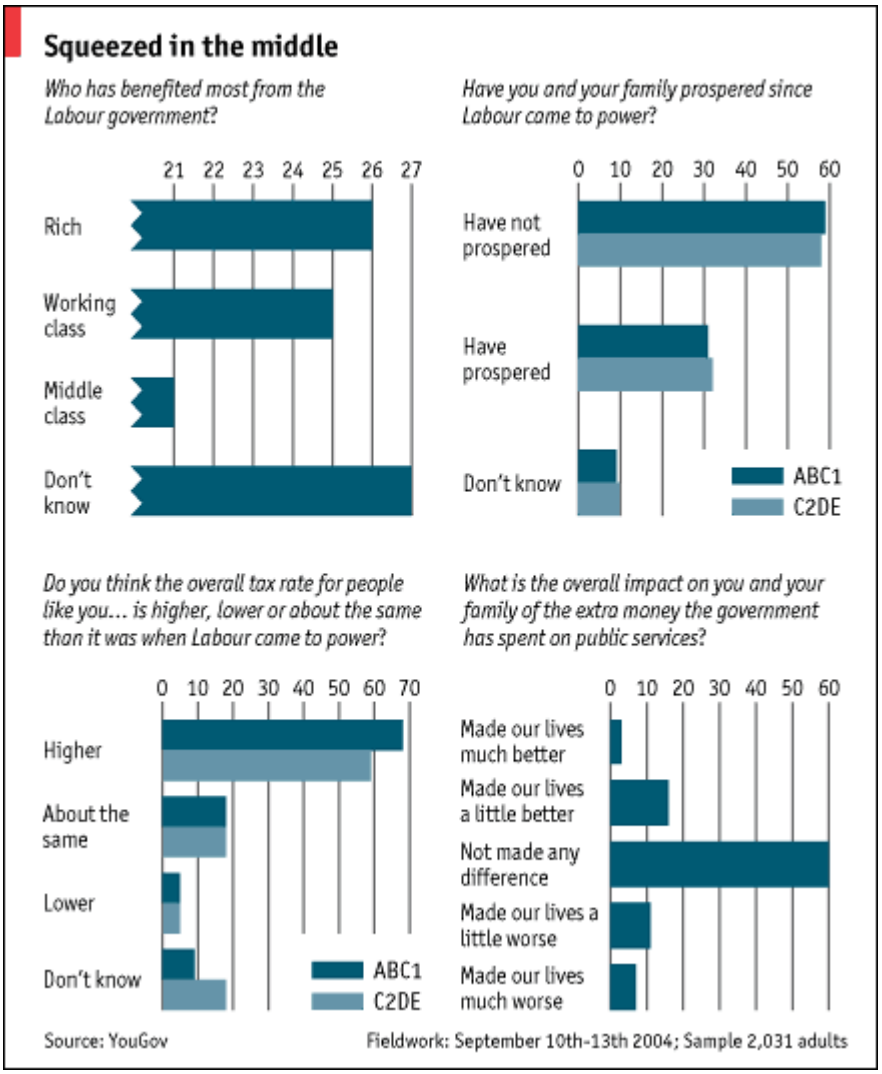
Politics

The grumpiness of the middle classes

Sep 23rd 2004
From The Economist print edition

Labour's spending has been financed largely by the middle classes. A poll for The Economist finds they've noticed and they're getting grumpy

AS THE Labour faithful gather in Brighton for what is expected to be their last annual conference before the general election, much of the grousing that always accompanies these occasions will be about the government's timidity, especially when it comes to tax. Party activists complain that, because Labour has not taxed with sufficient gusto, its traditional supporters will not bother to vote. The Tories' failure to revive under Michael Howard has encouraged the belief in Labour circles that the government has won the argument in favour of spending whatever it takes to improve public services.



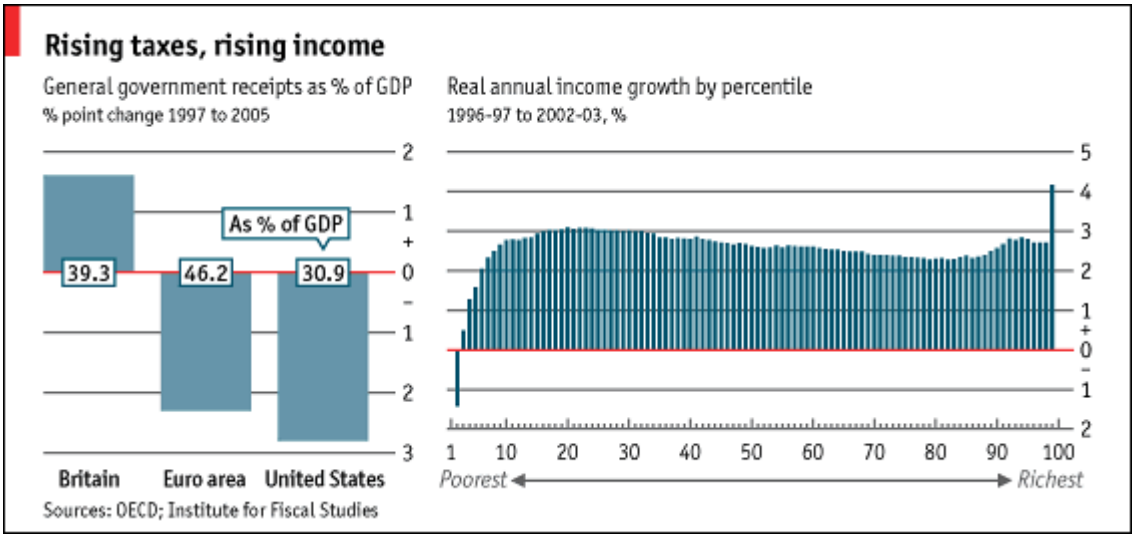
But a poll carried out for *The Economist* by YouGov suggests the opposite (see chart): that voters' tolerance for tax-and-spend policies is fast running out. And, worryingly for Tony Blair, who has so assiduously courted them, it is the middle classes that are seen to have done worst. (In Britain, incidentally, "middle class" describes people who are averagely well-off or better; in America, people who are averagely well-off or worse.)

According to the YouGov poll, 64% of respondents are aware that their tax bill has gone up since Labour came to power and very nearly as many expect it to rise further if Labour wins the next election. At the same time, 60% think that the extra spending on public services has not improved their lives, while those who believe it has made things better for them are only slightly more numerous than those who reckon things have got worse. Astonishingly, given the government's successful macroeconomic record, 59% of respondents—and 60% of the higher, ABC1 social groups—think they have not prospered under Labour.

How justified are the middle classes' complaints? The answer depends a bit on whether, for example, an individual has moved house and had to stump up for higher stamp duty. But a reasonable estimate, taking into consideration income tax, council tax and National Insurance, but ignoring the chancellor's £5 billion ($9 billion) a year raid on pension funds, which will hit people only when they realise they need to save more for their retirement, is that someone earning £50,000 a year is now paying about 37% of their income in tax. That's nearly 5 percentage points more than when Labour came to power in 1997. For someone on £30,000 a year, the tax burden has probably gone up by “only” about 2 percentage points.

Fiscal drag is mostly to blame. The chancellor has tended to up-rate tax allowances and thresholds in line with inflation. But because earnings usually rise faster than inflation, the number of taxpayers facing the 40% marginal rate has increased from 2.1m to about 3.3m since 1997. Fiscal drag will swell the ranks of higher-rate taxpayers to 4.4m by 2009, providing an extra £7 billion in revenues compared with those yielded if thresholds were linked to earnings. To put it another way, according to the Institute for Fiscal Studies, in 1997, the highest rate of tax kicked in at 161% of average earnings; now the figure is 143%. And if the chancellor continues to depend on fiscal drag to bail him out of his fiscal profligacy, by the time the 2009 election comes round it will be down to 129%.

In raising the voters' tax burden, the government has been moving in the opposite direction to most of the rich world (see chart). And the scope for further tax increases seems to be shrinking. In 1997, a poll found that 74% of respondents favoured higher taxes to fund public services. Last December, according to YouGov, that had fallen to 27%. An ICM poll, conducted at the beginning of this month for the TaxPayers' Alliance, a lobbying group, asked the straightforward question whether taxes should go up or down. Only 11% thought taxes should rise, while 58% wanted to see taxes cut.



It seems odd, given that the Tories always used to be the low-tax party, that they have not made more of this. The reason is that health and education have been close to the top of voters' priorities, and the Tories don't want to be seen as the party that will ruin public services. But, as taxes go on going up and voters get grumpier, that may change.

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Employment regulations

Scylla and Charybdis, or Patricia and Brussels

Sep 23rd 2004
From The Economist print edition

The prospect of new employment rules makes business groan

ACCORDING to the British Chambers of Commerce, new regulations have cost companies £30 billion (about $50 billion) since 1998. The rules that worry businessmen most are those affecting Britain's cherished labour-market flexibility. The most important of these has been the working-time directive, which limits working hours; but there have been several others, such as new rights for parents to take time off when they have a young child.

There were two new blows this week. On September 20th, Patricia Hewitt, the secretary of state for trade and industry, revealed a plan to extend paid maternity leave from six to 12 months and to raise paternity leave pay. She also advocated an extension of the right of parents of young children to ask for flexible working to include those looking after elderly relatives. The threat of new impositions on employers got a sour reception from the British Chambers of Commerce, which represent small businesses. They complained that the plan to extend paid maternity leave could have a crippling impact.

On September 22nd, the European Commission announced a proposal to revise the working-time directive, which imposes a maximum working week. Although Britain currently enjoys an “opt-out” from the directive—workers can agree with their employers to work longer than the maximum—the directive has been one of the main sources of extra costs for business in the past few years. Now the commission is proposing to tighten the directive further. The Confederation of British Industry says that it will fight the commission's proposals.

The CBI is angry that British businesses will have to negotiate opt-outs from the working-time directive with unions, rather than directly with individual employees. Although only a fifth of private-sector workers are now unionised, British business is worried that union power will now increase. And it is also concerned about the combination of the revised working-time directive with the new information and consultation directive, which will force British businesses with more than 50 employees to set up a works council. At worst, this might mean a re-unionisation of the British workplace combined with new union powers to compel management to reduce working hours.

Yet these proposals could have been worse. The opt-out remains. The period over which average working time is calculated has been extended from four months to 12 months: this will help seasonal employers in, for instance, holiday resorts. And the commission seems to have found a way around a European Court ruling which had classified periods when doctors are “on call”, even if they are tucked up in bed, as working time. “On call” time will be classified as work only if the employee actually does something.

One clear signal that the proposals are less dire than business leaders are portraying them to be is the reaction of union leaders. John Monks, head of the European Trade Union Confederation, says that the commission “has sided with the general employer offensive on working time”. It hasn't been a good week for business but it could have been a lot worse.

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Seaside towns

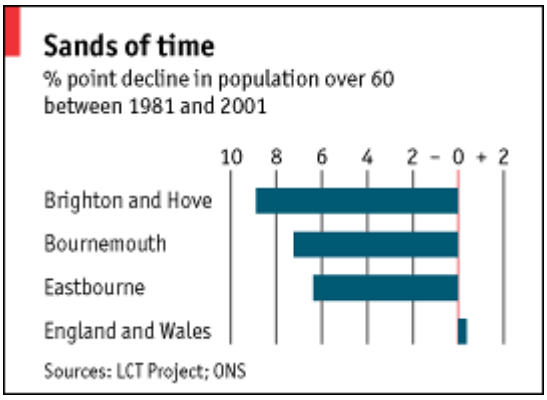
Brighton rocks

Sep 23rd 2004 | BOURNEMOUTH
From The Economist print edition

Britain's seaside swaps tea and scones for flavoured vodka and kebabs

THE south coast has been crumbling for years. Old entertainment piers collapse, beaches are washed away and the cliffs slide gently into the sea. The sense of living on borrowed time extends to the populace too. For most of the last century, Britain's coastal resorts attracted a disproportionate share of pensioners, drawn by the promise of sunshine and lower house prices. That is now changing.

“Major seaside towns were yesterday's destination for retirement,” says Phil Rees of Leeds University. Census data bear this out. Over the past two decades, the number of over-60s in many coastal towns has dropped, although it has stayed the same in Britain as a whole (see chart). The change has been particularly marked along the stretch of south coast that 20 years ago was home to the six greyest local authorities, where pensioners made up 31% or more of the population.



The population changes along Britain's south coast are bound up with the way holidaymaking has changed. Fifty years ago, according to John Millward, leader of Bournemouth council, the town's guest-houses filled up with holidaymakers from the cities. Mr Millward remembers tourist seasons in the 1950s and 1960s punctuated by “Glasgow fortnights, Birmingham fortnights and Sheffield fortnights”. When, in the 1960s and 1970s, buckets and spades started going to Spain, property prices fell, pensioners moved in and guest-houses turned into bed and breakfasts for the long-term unemployed and sick, who, Mr Millward says, “decided they might as well be somewhere nice by the sea.”

Some of them are still hanging on, but a wave of younger people has arrived and has changed the nature of the town. They have come to man the businesses that have arrived in the past few years. High costs have pushed them out of London; e-mail has made it easier for them to operate from places such as Bournemouth and stay in touch with other departments, or clients, elsewhere.

In Bournemouth, J.P. Morgan Chase now employs 4,200 people processing financial transactions, making it the largest employer after the council and the National Health Service. In all, 25% of workers have jobs in financial or business services. Bournemouth is hardly Square Mile-on-Sea: most jobs are still in the low-wage service sector, cleaning and cooking for participants in a conference trade that has partially compensated for the loss of tourism proper. But there is enough money around to make for an increase in house prices 11 percentage points ahead of the rest of Dorset over the past three years. More workers mean more night-life, which makes marketing a resuscitated Bournemouth to the young rather easier.

Price rises and kebab-munching night-clubbers may have helped put off the oldies, but holiday patterns are probably also responsible. Tony Warnes, a gerontologist at Sheffield University, says that people like to retire where they used to go on holiday. Fewer holidaymakers at the seaside eventually mean fewer pensioners retiring there. “Before,” says Bethan Thomas, also at Sheffield, “people pottered around the seaside until they died. Now they want to go off trekking in the Himalayas, or buy a place in France.”

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Wales

How green was my pampa

Sep 23rd 2004
From The Economist print edition

Homage to Patagonia

FINDING locals willing to work as waiters in Wales is difficult, so Wendy Tardioli, landlady of the Glamorgan Arms in Pontlliw, has imported one from Patagonia, where a few thousand members of a Welsh-speaking settlement established in 19th-century Argentina still survive. It's been a big success. The new recruit, she says, works harder and speaks better Welsh than the locals—with a slight Spanish accent but uncontaminated by Anglicisms. Other Welsh pubs that are also short of staff now want to do the same.

It may sound like a joke, but relations between Wales and its Patagonian outpost are hotting up. Next month will see the first official visit there by Alun Pugh, Wales's minister for culture and language, to coincide with the Patagonian Eistedfodd (culture shindig), complete with bards and druids. A local university is organising a conference on the Welsh diaspora in Patagonia, with input from Britain's National Archives. And in another first, Veronica Jones de Kiff, Patagonian-born and married to a Welshman, will on October 6th become the first person to take her naturalisation oath in the Welsh language.

Born into a Welsh-speaking family, Mrs Jones de Kiff came to Wales, like other ambitious Patagonians, to study Welsh. She now works in the international department of the Welsh football association, where her Spanish—"international football's second language", she says—comes in handy. Her English, she says apologetically, is much less good than her Welsh. But when you know two international languages fluently, the third probably matters rather less.

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Premature babies

Prayer and statistics

Sep 23rd 2004
From The Economist print edition

Very premature babies have bleak prospects, a new study shows

EVERY extra week in the womb helps your chances in life. A new study of very premature babies now shows how risky it is to come into the world at 23 weeks rather than the normal 40. Medical advance is giving babies a better chance of survival: 20 years ago 20% of British babies born weighing less than one kilo (2.2lb)—typically very premature—survived; now the figure is 80%. Some 7% of British babies are now born very early—one of the highest figures in the world, thanks to high rates of IVF and teenage pregnancy.

Researchers for the EPICure study, based at Nottingham university, have been studying 1,200 babies born at 25 weeks or below in 1995. 314 left hospital alive; at the age of two and a half, 50% had some form of physical disability. Half of these were severe: blindness, deafness, cerebral palsy and the like. The latest phase of the study looks at a cohort aged six, measuring intelligence, language and problem-solving ability.

The new findings showed fully 40% of the babies studied had “moderate to severe” problems in this regard, compared with 2% of the control group. Intensive care can improve survival chances but also damage the baby's body and mind.

This raises a lot of tricky questions about how and when to treat very premature babies. Parents may be less willing for doctors to resuscitate a pre-term baby if they think exhaustion and misery are likely to ruin the rest of their lives. But if that risk-averse thinking becomes more common, babies that might have had a happy and healthy future will be left to die just because they were born too early. Some parents will be glad even of the tiniest, most ill baby; others shun any risk at all. Society largely accepts such parental wishes in abortion decisions, but less easily when babies have already been born.

Practice varies across the world. “At 23-24 weeks if parents say do nothing we don't. Above 25 weeks we treat,” says Maureen Hack, an American paediatrician. The emphasis there is on bringing the fetus alive into the world. Dutch doctors, by contrast, try to prolong the pregnancy. That means fewer premature babies born alive, but a greater chance that the survivors reach normal childhood. A study comparing treatment of babies born before 26 weeks in New Jersey and the Netherlands showed twice the survival rate among the American babies—but also ten times as many cases of disabling cerebral palsy, and more than four times as many days of (expensive) assisted ventilation.

Dilemmas are inevitable. Britain's current approach is that doctors take a clinical decision, in conjunction with parents. There's no hard-and-fast rule: even at full term, the treatment received by a very sick baby will depend partly on the parents' wishes. Medical ethicists are now re-examining how to treat premature babies “on the borders of viability”.

Care is rationed by scarcity as well as ethics. The British Association of Perinatal Medicine says the ideal is one nurse per cot in the most intensive neo-natal units. That's the norm in America, says Rob Williams, of BLISS, a charity, but very few British hospitals manage it. Adult intensive-care beds are better staffed.

Spending more on neo-natal care—and thus avoiding shuffling babies stressfully between hospitals—would mean more and healthier survivors of premature birth. Medical attention is shifting towards ways of making neo-natal care less damaging to the babies whose lives have just been saved. Ideas include making the high-tech incubators as similar as possible to the womb, reducing noise, lighting and movement, and keeping parents nearby. That means a bigger chance of a future healthy life for the baby—and a less agonising time for the parents.

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Libel

No comment

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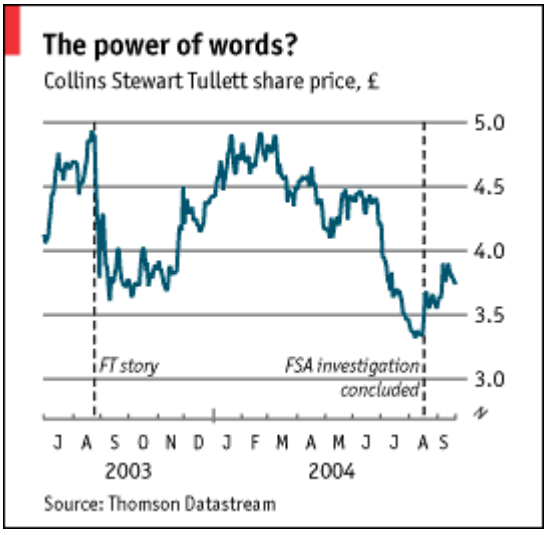
The Financial Times is defending a £240m libel action



WHERE would business journalism be if companies started suing for libel whenever critical coverage led to a drop in their share price? That's the worry raised by a £240m ($430m) defamation lawsuit against the *Financial Times*, (part-owner of this newspaper) by Collins Stewart Tullett, a City broker. In August 2003 the *FT* published stories based on allegations of malpractice made by a disgruntled employee of the firm, who was contesting his dismissal in court.

The allegations (strenuously denied) attracted widespread attention. Collins Stewart's share price tumbled (see chart). But last month an investigation by Britain's City watchdog, the Financial Services Authority, closed with a decision to take no action. Now the firm is seeking redress.

The first big battle will be in a hearing scheduled for October 4th, which will focus on the part of the claim (£230.5m) that is based on the fall in the company's share price. No stranger to financial economics, the firm argues that a share price reflects the most accurate estimate of the present value of future earnings, so the fall in its market capitalisation represents the damage the brouhaha has done it. The *FT* will ask a judge to strike out that part of the claim.

At the full jury trial, expected in April next year, the *FT* will argue that its reporting was based on a publicly available court document. In general, English law says documents of this kind are “privileged”—meaning that their contents, however incendiary, can be quoted with impunity. But in this case there's an argument about the exact status of the documents concerned. If the *FT* loses at this stage there will then be a further case involving the size of damages. That could involve the entertaining prospect of expert economists duelling over how markets work and what stock prices really mean.

A victory by Collins Stewart could lead to an increase in the number of libel suits. Companies will find it much easier to claim that they've been damaged if they can cite movements in their share price. It would also raise the potential cost to newspapers of losing a suit: for a big company, even a small dip in the share price can mean billions.

But identifying the exact relationship between a particular piece of news coverage and a share price fluctuation will be a demanding piece of econometrics. And true believers in efficient markets may find themselves caught up in their own argument: if markets are that rational then the share price of a libelled company should automatically rebound to its original level once the firm has been vindicated.

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Plea bargaining

Pleas please me

Sep 23rd 2004
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Britain's top judge reveals all

ANYONE with a cursory knowledge of TV crime dramas knows the difference between the English and American legal systems. In England, guilt is decided by grave, bewigged men assisted by panels of fair-minded jurors. In America, by contrast, deals are cut by slick lawyers, who cynically offer guilty pleas in return for reduced sentences. It's a crude distinction, but an emotionally powerful one. Lord Chief Justice Woolf, Britain's top judge, was pilloried in the press this week for suggesting that the two legal systems are more similar than screenwriters make out.

Lord Woolf was trying to set down in writing how far judges could “discount” minimum prison terms for defendants who plead guilty. He suggested that 10% might be knocked off the tariff if a defendant changes their plea during the course of a trial. If a date has been set, but the trial hasn't started, a discount of 25% could be applied; and if a felon pleads guilty at the earliest opportunity, he could be breathing fresh air up to 33% sooner.

This is roughly what judges do already, with a few idiosyncratic variations. Where the evidence against a defendant is slight, and a trial would cause misery to witnesses (a rape case, for example), some judges currently reward guilty pleas with a discount greater than one-third; stronger evidence means a smaller reduction. Discounts are stingy compared to those offered in America, where they can cut a prison sentence by four-fifths, according to Candace McCoy at Rutgers University.

English judges are also very restricted in the advice they can give to wavering defendants. But the link between admissions of guilt and shorter prison stays is nonetheless well known. That explains why, last year, guilty pleas in the Crown Court outnumbered guilty verdicts by more than four to one. In the magistrates' courts, where the great majority of criminal cases are heard, the ratio was 15 to one—only slightly less than the American ratio of 20 to one in felony cases.

The odd thing is not the discount rates Lord Woolf's committee came up with, but the fact that sentencing is being discussed so openly. The English legal system has long maintained a coy silence about plea-bargaining: judges and lawyers dislike the term, and efforts were made to suppress the first major study of the practice. Mary Vogel, who follows the subject at Leicester University, says that this has to do with national traditions. Whereas the American system is based on the democratic idea that citizens—even criminal ones—can make decisions about their own fate, the British courts are rooted in royal traditions of clemency. The judge acting on his own discretion is the modern equivalent of the king's messenger riding to the gallows.

An especially strange spectacle is presented by Lord Woolf, a fierce defender of judicial discretion, setting rules for other judges to follow. But there is a scramble to define judicial powers. The home secretary, David Blunkett, has moved to set minimum jail terms for murderers, under the widely accepted—but never properly explained—notion that the crime is qualitatively different from all others. If the Lord Chief Justice doesn't set down judges' powers in writing, somebody else will.

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British fashion

By George

Sep 23rd 2004 | LEEDS
From The Economist print edition

Britain has produced the first global clothing brand from a supermarket

TO THE envy of Paris, New York and Milan, a British brand has become one of the fastest-growing lines of clothing in America. It is also causing something of a stir in Canada, Germany, Japan and South Korea. The origin of this global assault is glamorous Lutterworth, the Leicestershire base of George.

If you don't know George, then you don't shop at Asda or its American parent, Wal-Mart—the world's biggest retailer. George was named after George Davies, founder of the Next clothing chain. Mr Davies first produced a George collection for Asda back in 1990. The brand was then absorbed by the Leeds-based supermarket chain, which was acquired by Wal-Mart in 1999 for more than $10 billion. The folks back at Wal-Mart's base in Bentonville, Arkansas, took such a shine to George that earlier this year they decided to make it a global product.

A complete George outfit can be bought for £25. The bargain pricing will continue: George's clothes are to be produced through Wal-Mart's legendary global-procurement system, and Wal-Mart, with sales of $256 billion last year, gets to negotiate very good deals with its suppliers. But Lutterworth is also having to cater to local tastes. Best-selling sizes, obviously, vary a lot between America and Japan. And South Korean girls favour paler colours.

Mr Davies is no longer involved with George. He defected to Marks & Spencer (M&S) to produce Per Una, now a successful range of women's clothing for Britain's best-known but deeply troubled retailer. In a shake-up following its successful defence against a takeover bid by Philip Green, who owns BHS and Top Shop, M&S bought Per Una from Mr Davies for £125m, although he will remain as boss of the range for another two years.

But here, given Mr Davies's success with George, is the interesting bit: according to the supposedly secret sales surveys carried out by Taylor Nelson Sofres, a retail research-agency, Asda recently nipped ahead of M&S in volume terms to become Britain's biggest clothes retailer. By value, M&S apparently kept the lead. Many in the rag trade said it was an aberration. Mr Green said the figures were “rubbish”. Nevertheless, most of Asda's clothing sales are George, and there is no getting away from the fact that it does very well. Moreover, George's success points to broader retailing trends.

The first of these is that fashion is no longer all about pricey designer-brands. Gap, H&M and Zara prove that. Fashion has gone upmarket and downmarket at the same time. The transformation of Selfridges by Vittorio Radice—who also defected to M&S, with less success—illustrates how £5 tops can be sold alongside £500 Gucci bags: women happily wear them together.

The second trend is the supermarkets' move into general merchandise, from £30 DVD players to £4 denim jeans. It has led to a transformation of British shopping habits. Five years ago only about 8% of Asda's customers bought clothes; now one in three do. And like all trends, things keep evolving. Asda is now opening its fifth stand-alone George store, in Liverpool. It has already opened George stores in Leeds, Croydon, Preston and Northampton. This is part of an experiment to see if the brand can also work as a chain in its own right. If it can, the wheel will have turned full circle.

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Bagehot

Kennedy's paradox

Sep 23rd 2004
From The Economist print edition

The Lib Dems think they can destroy the Tories; but they may instead save them

Get article background

AT WHAT seems likely to be the last party conference season before the next election, the Liberal Democrats, the perennial losers of British politics, are alone in relishing the contest to come. The activists who gathered in Bournemouth this week are buoyed up by recent by-election successes, an eclectic collection of nakedly populist policies, the conviction that Iraq has done for Tony Blair and the belief that the Conservatives are in irreversible decline.

The Lib Dems, in various guises, have had their share of false dawns. But their confidence these days borders on the cocky. The party does not for a moment think it will win the election, but it does reckon it is on the way to replacing the Tories as the main opposition to Labour. Lord Razzall, the Lib Dems' formidable campaign strategist, told the conference that the Conservatives would not regain power “in our lifetime”. As a discredited Labour government ran out of energy and time, he said, office would beckon for the Lib Dems sooner rather than later.

How well founded is this optimism? In some ways, the “narrative”, as New Labour types used to say, is quite plausible. No one doubts the damage Iraq has done to Mr Blair's trust ratings, and therefore to the government. In particular, middle-class women, the group that is angriest with Mr Blair, are attracted by the Lib Dems' anti-war stance.

The Tories, according to Mark Oaten, the Lib Dems' slick home affairs spokesman, have been left behind by changes in society—the end of deference, the decline of organised religion, the rise of multi-ethnic cities and so on—which they are powerless to influence. Consequently, they are being marginalised as the party of the shire counties and the nostalgic elderly. This is hardly an original insight, but there are plenty of progressive Tories who, despairing of their party's ability to adapt to the realities of modern Britain, would agree with Mr Oaten.

The Lib Dems have also ditched any policies that might put off potential supporters, such as raising the basic rate of income tax, and they have stopped banging on about things that do not stir the popular imagination, such as proportional representation. “If you were against the Iraq war; if you are against paying university tuition fees; if you don't like the council tax; if you are in favour of free personal care for the elderly and a higher state pension and you also think it's fair to ask people earning more than £100,000 a year to pay a little more, then you should vote Liberal Democrat,” chants Mr Oaten.

The Lib Dems claim (they would, wouldn't they) that all this has been carefully costed and will be offset by painless savings elsewhere, made by, for instance, scrapping the Department of Trade and Industry. Never mind the disastrous impact on the universities of abolishing tuition fees; never mind that the Lib Dems' alternative to council tax is a local income tax that would bear most heavily on working families on not much more than middling incomes; never mind that raising the marginal rate of tax to 50% on the 1% who earn more than £100,000 a year would almost certainly fail to bring as much money as they claim. If it's nasty, the Lib Dems will take it away; if it's nice, they will let you have it.

When it comes to improving the country's public services, the Lib Dems condemn Labour and the Tories for foisting false choices on the electorate. People, they say, don't want choice: they just want good schools and hospitals nearby. According to the Lib Dems, the way to achieve that is to trust teachers and doctors to get on with the job and to give them plenty of money. Lib Dem faith in the beneficence of public-sector producers knows no bounds. The possibility that choice might be the best way of levering up standards is too troubling an idea for most of them to contemplate.

Too Lib Dem to be liberal

To be fair, a number of leading Lib Dems, including Vincent Cable, the party's impressive shadow chancellor, and David Laws, another of the party's front-bench Treasury spokesmen, are uneasy about their party's patchy intellectual rigour and policy opportunism. Mr Cable is having some success in introducing a more market-based approach to policy in some areas, such as the environment.

In the hope of encouraging activists to see how the economic liberalism the party once stood for might be married to today's social liberalism, Mr Laws, with like-minded colleagues, published a book of essays on the eve of the conference, entitled “The Orange Book: Reclaiming Liberalism”. But plans to launch the book at a fringe meeting were abandoned at the last moment. Charles Kennedy, the Lib Dems' resolutely anti-intellectual leader, clearly thought that now was not the time to debate the party's future direction. The message was that everyone must stay on-message. If inconsistency and ambiguity are vote-winners, so be it.

That may well be the best way of targeting both Labour and Tory voters at the same time. Yet there is a paradox in the Lib Dems' strategy. They see the Tories as the more vulnerable of the two main parties and are focusing their energies disproportionately on Conservative seats in which the Lib Dems came a close second in 2001. They are sure to pick off some high-profile Tories. Three shadow cabinet members—Oliver Letwin, David Davis and Theresa May—are in peril. But, as John Curtice of Strathclyde University argues, by taking disillusioned, anti-war voters from Labour, the Lib Dems will also inevitably deliver a clutch of Labour-held marginals to the Conservatives—perhaps enough for there to be a hung parliament. The Lib Dems think they are on the verge of destroying the Conservative Party as a political force. But their own success could just be the thing that puts the Tories back in business.

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A divided Union

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From The Economist print edition

Reuters

The European Union has achieved much, but it may now be pushing up against its limits, says Gideon Rachman

FOR many centuries Europe was the world's most powerful, prosperous and technologically advanced continent. That period of European cultural and political dominance came to a definitive end with the second world war. In 1945 Germany was defeated and in ruins; France was half-starved and humiliated; Britain was bankrupt and on the point of losing its empire; Spain was a backward, isolated dictatorship; and the countries of central and eastern Europe had been absorbed into a Soviet empire. Nobody would have guessed that Europe was at the beginning of a new golden age.

In 2004, a continent that had been wracked by war for centuries can look back on almost 60 years spent largely at peace. A continent that lay in economic ruins in 1945 is now prosperous as never before. A continent that in 1942 could list only four proper democracies is almost entirely democratic. A continent that was divided by the iron curtain until 1989 now enjoys free movement of people and common political institutions for 25 countries, stretching from the Atlantic coast of Portugal to the borders of Russia.

This new period of peace and prosperity has coincided with the rise of a new form of political and economic organisation. The founding fathers of what is now the European Union—Jean Monnet, a French civil servant, and Robert Schuman, a French foreign minister of the 1950s—were convinced that the origins of conflict in Europe lay in the continent's system of competing nation-states. As Schuman put it, “Because Europe was not united, we have had war.” Those founding fathers were determined to build a new union in Europe that would banish conflict for good. Their building-blocks were economic, but their goals were political.

Starting with agreements between six countries on the pooling of coal and steel resources in 1951 and moving on to the creation of a common market in 1957, the EU has gradually spread into a plethora of activities. Today it is hard to think of a field of public policy in which it is not active. It is involved in everything from foreign policy to immigration, and is reckoned to be responsible for around half of all new laws passed in its member states.

The people who run the European Commission in Brussels like to believe that this golden age of peace and prosperity is directly linked to the rise of the EU. Yet this view is often contested. Peace in Europe, it is argued, could equally be credited to the presence of American troops on European soil, and prosperity to the same causes of economic growth as in the United States or Asia, such as rising productivity and increasing trade. As for freedom, the revolutions in central Europe and Spain, Portugal and Greece were not led from Brussels.

Indeed, say critics of the EU, far from promoting peace, prosperity and freedom, it now threatens all of these achievements. In Britain, for example, Eurosceptics see a direct threat to British self-government and democracy in the many laws emanating from institutions in Brussels over which the British electorate

has no control. In Britain and elsewhere, critics also argue that the EU is increasingly responsible for a tide of unnecessary regulation that is engulfing the European economy. And some believe that its overweening ambition may end up causing exactly the sort of conflicts that it has been seeking to eradicate. Martin Feldstein, an eminent American economist, has argued that the launch of a single European currency could cause political tensions culminating in war.

But for now the EU is riding high, with more and more countries seeking to join it. Having started with just six members in 1957—Belgium, France, Germany, Italy, Luxembourg and the Netherlands—the EU now has 25. Its biggest ever expansion was completed in May this year with the addition of ten new members, mainly from the former Soviet block. The Poles, the Spanish and others undoubtedly won their freedom without any help from Brussels. But they all saw joining the EU as a way of consolidating democratic gains and spurring economic and political modernisation. For much the same reasons Turkey and the Balkan countries are now waiting in the wings.

Enlargement should be enough of a challenge to keep the Brussels machine humming for the foreseeable future. But oddly enough, many of the most ardent believers in the creation of a European federation see enlargement as an unwelcome distraction from the EU's most urgent business: to develop into a real political union. Enlargement and political union—“widening” and “deepening” the EU—have often been portrayed as opposing courses, but in fact in the past five years they have moved ahead simultaneously. On January 1st 2002, 12 EU countries ditched their national currencies and adopt a new single currency, the euro; and in June 2004, the 25 EU governments agreed on the Union's first ever written constitution.

Over the past decade Europe, a continent often accused of sclerotic caution, has displayed a daring political imagination that has produced a run of successes. Javier Solana, the EU's foreign-policy chief, explains: “Our philosophy is jump in the pool, there is always water there.”

Over the past decade Europe has displayed a daring political imagination

The trouble with that kind of philosophy is that it can eventually lead to a nasty accident, and indeed the European project looks increasingly troubled. Economically, the EU is falling further behind the United States, and can only envy the dynamism of China or India. Politically, its members have been at each other's throats over Iraq, the management of the euro and the constitution. Perhaps most dangerously of all, the EU is plagued by a lack of popular understanding and enthusiasm.

The penalties of success

The survey will argue that many of the EU's current difficulties stem from its past successes. In post-war Europe, achieving peace and re-establishing prosperity seemed like urgent and difficult tasks that required political sacrifices. Now, though, long years of peace and prosperity in western Europe, together with the collapse of the Soviet threat, make further European integration seem much less urgent. Indeed, the very depth of the political integration achieved so far has caused something of a backlash as the EU has gained new powers that threaten deeply rooted national traditions. Sometimes this has been in important fields such as frontier controls and fiscal policy, but sometimes, too, it has been in areas that irritate by their triviality.

The post-war gains in European prosperity may also have begun to create their own problems. Rich countries such as Germany and France were encouraged to develop elaborate welfare states which are becoming increasingly unaffordable as populations age. Before the creation of a single EU market and a single currency, such problems could be regarded as mainly national in character. But now they can cause tensions across the Union.

Enlargement is another example of a success that makes the EU a riskier place. By increasing the diversity of political interests and views within the Union, it has made them much harder to contain within a single framework.

European federalists—the heirs to Monnet and Schuman—are well aware of these problems. Some believe that a new impetus for European unity can be provided by trying to build up the EU into a new superpower—a global force that can equal the United States. But so far any moves in that direction have served only to deepen divisions within the EU, in particular over attitudes to America.

The EU's new constitution represents another effort to preserve and deepen European unity, but it too could backfire. For the constitution to come into force, it must be approved by all 25 EU countries. At

least 11 of them are likely to hold referendums, and in a few of those, notably Britain, the verdict is likely to be negative. Such an outcome could well provoke a crisis within the Union.

This survey will conclude that the EU may indeed split. But a split need not be a disaster. It could lead to a multi-layered EU in which different countries adopt different levels of political integration and experiment with different economic models. If the EU were preserved as an over-arching framework, it could actually benefit from such diversity. But there is also a darker, if less likely possibility. A split in the EU could cause Europe once again to divide into rival power blocks. That could threaten what most agree is the Union's central achievement: peace in Europe.

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Peace in our time

Sep 23rd 2004
From The Economist print edition

Europe has largely avoided war for nearly six decades, but the European Union no longer gets the credit

AFP

Mitterrand and Kohl made history

IN THE whole of Europe there is probably no more blood-soaked battlefield than Verdun. In 1916 some 800,000 French and German soldiers were killed or wounded, fighting inconclusively over a few square miles of territory near the Franco-German border. The young Charles de Gaulle was wounded three times and captured at Verdun. Louis Delors, a 21-year-old French private, suffered terrible injuries there and was almost killed by a German officer who was finishing off the French wounded with a pistol. In the 1990s his son, Jacques Delors, became the founding father of a monetary union of France, Germany and ten other European countries. Mr Delors's two great collaborators were Helmut Kohl, the German chancellor, whose father had also fought at Verdun, and François Mitterrand, the French president. In 1984 these two leaders, in a historic act of Franco-German reconciliation, walked hand in hand across the battlefield that had been a killing ground for so many young men from both countries.

Many of the European Union's most ardent supporters still see the EU as a crucial bulwark against the return of war to Europe. In pressing the case for monetary union, Mr Kohl argued that adopting the euro was ultimately a question of war and peace in Europe. When efforts to write a European constitution looked like stalling, Elmar Brok, a prominent German member of the EU's constitutional convention (and confidant of Mr Kohl), gave warning that if Europe failed to agree on a constitution, it risked sliding back into the kind of national rivalries that had led to the outbreak of the first world war.

Remember the bad old days?

Such arguments resonate particularly strongly among an older generation of French and German politicians, but also have wider currency. Timothy Garton Ash of St Antony's College, Oxford, one of Britain's most astute observers of European affairs, says in a recent book that the Union is needed “to prevent us falling back into the bad old ways of war and European barbarism which stalked the Balkans into the very last year of the last century.” Mr Garton Ash concedes that “we can never prove that a continent-wide collection of independent, fully sovereign European democracies would not behave in the same broadly pacific way without the existence of any European Union. Maybe they would, but would you care to risk it?”

Believers in the pacifying effects of the drive for European unity acknowledge the contributions to peace in post-war Europe made by American troops and by the spread of prosperity and democracy. But they

argue that the EU has played the central role, by forcing European leaders to co-operate intensively and continuously, by proving that membership of the Union brings prosperity and by demanding that all EU countries adhere to basic principles of democracy, human rights and the peaceful resolution of disputes.

Seen in this light, EU enlargement is part of the same “peace project” that was initially centred on reconciliation between France and Germany. Countries that apply to join the EU first have to meet a set of basic democratic criteria, and have to put aside old territorial disputes. Eight former members of the Soviet block were admitted to the EU this year, and Romania and Bulgaria are lined up for entry in 2007. But the idea that enlargement of the European Union will inevitably resolve conflicts and spread freedom and democracy will face even bigger tests in future.

The European Commission in Brussels has already made it clear that all the Balkan countries are potentially eligible for membership, in the hope of encouraging them to make peace and introduce democratic reforms. Croatia, which earlier this year became the first major combatant in the Balkan wars to be formally accepted as a candidate for EU membership, had to step up its co-operation with the International War Crimes Tribunal in The Hague before negotiations became possible.

The EU was rightly castigated for its inability to prevent war in the Balkans in the 1990s, and many Europeans felt humiliated by the need for American military intervention to end the conflicts in Bosnia and Kosovo. But the EU is taking over the peacekeeping mission in Bosnia from NATO later this year in what will be the Union's biggest ever military operation. In the longer term, it is hoped, the prospect of EU membership may help to cement the fragile democracies and the peace settlements now in place across the Balkans.

An ever wider Union

A similarly ambitious logic is being applied to Turkey's aspirations to join the Union. Although many EU politicians and citizens are worried about admitting a large Muslim nation into the Union, the proponents of Turkish membership have the upper hand. Turkey is likely to be invited to start negotiations to join the EU later this year. Once again, the key arguments are about peace and the spread of freedom and democracy.

At a time when relations between the West and the Islamic world are so delicate, most EU leaders seem

to feel that refusing to admit a large Islamic country into the Union would be seen as a disastrous confirmation of the "clash of civilisations". European diplomats, for their part, hope that admitting Turkey to the EU will bring confirmation that Islam is not incompatible with western values. They point out with some pride that the prospect of EU membership has already driven forward reforms in Turkey such as increased political and civil rights for the Kurdish minority and the abolition of the death penalty.

Many citizens fear that rather than exporting stability, the EU will import instability

For geo-strategic thinkers sitting in foreign ministries in London, Paris and Berlin, the arguments for using the EU to spread peace and democratic stability seem compelling. But ordinary European citizens find them much less convincing. Many fear that rather than exporting stability, the EU will import instability. In western Europe, public debate about EU enlargement has tended to concentrate on fears about competition from low-cost labour and waves of immigration. So far such fears have proved containable, and the admission of the new members from central Europe has not caused too much of a fuss. But the new central European members, though poorer than the European average, are smallish (except for Poland), and all are predominantly Christian.

Turkey, which on current trends will have a larger population than any current EU member by 2020, is a different proposition. Because all EU citizens are free to live and work anywhere in the EU, there could be serious resistance to Turkish membership in France, Germany and the Netherlands, where the rapid growth of Muslim populations in the past 30 years is already a highly sensitive issue.

Even without such worries, the traditional arguments for European integration as a "peace project" have anyway been losing force with the passing years. The current generation of EU leaders still has some memories of the depredations of war in Europe. Gerhard Schröder, the German chancellor, never knew his father, who was killed in the second world war; Jacques Chirac, the French president, lived through the war as a child. But for most younger Europeans, the threat of war in western Europe now seems almost unimaginably remote.

The expansion of the EU beyond the original six also added new countries with different historical experiences. Although some Britons, such as Mr Garton Ash, take the threat of a recurrence of war in Europe seriously, the British have generally approached the Union in a very different spirit from the French and Germans. Whereas statesmen such as Monnet and Schuman considered the 1939-45 war as the final proof that traditional European political structures needed to be radically changed, the British tended to see it as a vindication of their own long-established democracy and as confirmation of their anti-continental prejudices. As Margaret Thatcher, a famously Eurosceptic British prime minister, remarked: "In my lifetime all our problems have come from mainland Europe and all the solutions from the English-speaking nations across the world." The British are wary of dreams for political union in Europe. Unlike their French and German counterparts, British politicians have always wanted the EU to be above all about free trade.

Changing the mix

As the EU has expanded, so Britain has become less isolated in its resistance to the idea that European unity is essential for the maintenance of peace. When in 2003 Sweden held a referendum on whether to join the euro, Goran Persson, the Swedish prime minister, used the peace argument, but watched it fall flat in a neutral country that has been at peace for nearly 200 years. The Swedes voted "no". The new EU members in central Europe also bring a different perspective to the European Union. Whereas the traditional "builders of Europe" were suspicious of nationalism and keen to build up supranational institutions at the expense of the nation-state, many of the central Europeans are still joyfully re-asserting their own national identities after decades of Soviet domination.

Nonetheless, all these countries were eager to join the EU. They saw membership as an assertion of their European identity, as well as a ticket to prosperity and some protection against any threat from a resurgent Russia. But they are also much less enthusiastic than western European federalists about an "ever closer union" for Europe as spelled out in the Treaty of Rome. Vaclav Havel, the hero of the Velvet Revolution and former president of the Czech Republic, explains that for countries that have recently thrown off Soviet domination, "the concept of national sovereignty is something inviolable".

For a variety of reasons, then, the most powerful traditional argument for European unity, peace, has been losing force. European federalists are beginning to look for new rationales for European unity.

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E pluribus unum?

Sep 23rd 2004
From The Economist print edition

The pros and cons of becoming a superpower

Reuters

Birth of a nation?

IF EUROPEANS no longer feel that “ever closer union” is needed to avert war, what new project might unite them? For many European leaders the answer is obvious: the EU must strive to become a global power. In his opening address as president of Europe's constitutional convention in 2002, Valéry Giscard d'Estaing, a long-serving former president of France, laid out his hopes: “If we succeed in 25 or 50 years...Europe's role in the world will have changed. It will be respected and listened to, not only as the economic power it already is, but as a political power which will talk on equal terms to the greatest powers on our planet.”

The constitution drawn up by Mr Giscard d'Estaing and his collaborators tries to advance this ambition. If and when it is ratified, the EU will have a “foreign minister” in charge of his own diplomatic corps. The constitution also commits the EU to the “progressive framing of a common defence policy”. The British and other nation-staters protest that all this sounds more impressive than it really is. The foreign minister will simply be a co-ordinator with a fancy title who will have no power to over-rule national foreign policies. Decisions about troop deployment will remain in the hands of national governments.

But the symbolism of choosing titles such as foreign minister and president for the EU's senior officials is both deliberate and significant. In foreign policy, as in so many other areas, the EU's powers tend to build up through a series of small steps, not in one massive leap. Ben Bot, the Dutch foreign minister, reflects that only 20 years ago EU ministers felt it would have been too controversial to have a formal discussion of foreign and security policy.

Yet even as Mr Giscard d'Estaing and his conventioneers laid out their plans for “ever closer union” in foreign affairs, events outside the conference chamber mocked their aspirations. The constitutional convention took place against the backdrop of bitter European divisions about the war in Iraq. With an anti-war camp led by France and Germany and a pro-war camp led by Britain and backed by Spain, Italy and Poland, the EU's hopes of a “common” foreign policy looked forlorn.

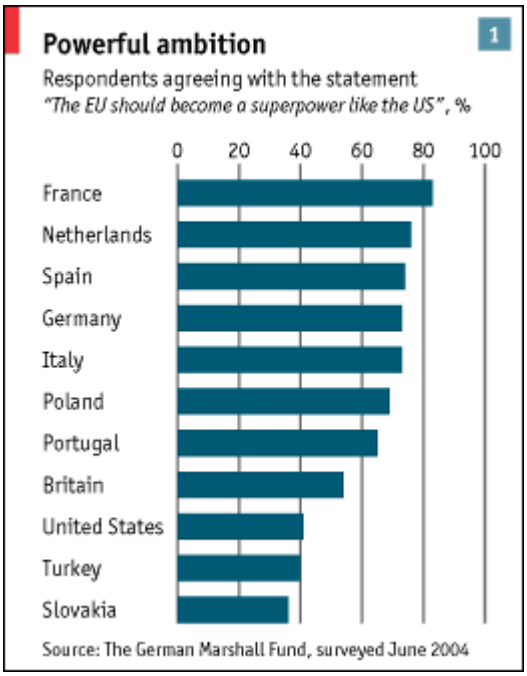
The Iraq dispute was disturbing not just because of its bitterness, but also because it revealed that the EU was split between two competing visions. One of them, most closely identified with France, is known as “multipolarity” or “Euro-nationalism”. In essence, it calls for the EU to become an independent actor on the world stage to counterbalance the United States. The other vision, most closely identified with Britain, is known as Atlanticism. This holds that the “western alliance”, forged in the cold war, remains vital today. Tony Blair, Britain's prime minister, argued that trying to build up Europe as a counterweight to the United States was a profoundly misguided and dangerous idea.

The very fact that the EU was divided over Iraq might have been expected to dishearten the Euro-nationalists, and initially it did. But many Euro-nationalists ultimately took heart from the Iraq crisis, for beneath the divisions between European governments they saw a fundamental unity in the anti-war sentiment of the European public. For example, although Spain's then prime minister, José María Aznar, supported the war, only 4% of the Spanish public agreed with him, and his party lost power at the subsequent election, albeit after a terrorist attack on Madrid just before polling day. Even in Britain a large majority of the public seemed opposed to the war.

After a slew of anti-war demonstrations across Europe on February 15th 2003, Dominique Strauss-Kahn, a former French finance minister and passionate pro-European, proclaimed: “On Saturday February 15th, a new nation was born on the street. This new nation is the European nation.” Mr Giscard d'Estaing also felt that the anti-war movement marked the birth of a “European public consciousness”.

The emotions stirred up by an impending war, although powerful, can also be ephemeral. But those who believe that there is enough common ground in time to underpin a united European approach to world affairs have other evidence to draw upon. A poll carried out in Europe for the German Marshall Fund of the United States earlier this year found widespread support for the idea that: “The European Union should become a superpower like the United States.” Not unexpectedly, 83% of French respondents and 73% of Germans agreed, but so did over 50% in countries whose governments had supported the Iraq war, such as the Netherlands, Poland and even Britain (see chart 1).

Support for the idea of Europe as a superpower does not necessarily translate into support for automatic opposition to the United States. Asked if they supported European superpower status to “compete more effectively with the US”, only 36% of French and 37% of British respondents agreed. Support in Germany and the Netherlands was even weaker. But large majorities in most of the countries supported European superpower status in order “to co-operate more effectively with the US” in dealing with international problems.



This points to a less aggressive version of Euro-nationalism which holds that Europe alone is too small to be able to influence a world soon to be dominated not only by the United States but also by India and China, superpowers with populations of over a billion each. As Danuta Hubner, the new European commissioner from Poland, puts it: “We should not forget that collectively we make up only about 11% of the world's population.” Seen in that light, Europeans need to group together to defend common interests.

Euro-nationalists believe that there is a distinctive European approach to the world that needs to be defended. Europeans, they argue, are more individualist than Asians but more collectivist than Americans. Opinion polls show that Europeans are generally less religious than Americans, less inclined to believe that war is sometimes necessary to achieve justice, and more inclined to think that success or failure in the world is determined by luck or social forces rather than personal effort. Such attitudes have political consequences. They mean that domestically Europeans are more likely to support a “European social model” with generous welfare provision; and that internationally Europeans are more inclined to express support for multilateral institutions such as the United Nations or the International Criminal Court. Euro-nationalists hope that in time an EU foreign policy can develop on the model of European trade policy, where the EU already acts as a block and is taken just as seriously as America.

Yet there are strong reasons for doubting that an attempt to turn the EU into a political superpower will provide it with a fresh impetus. Indeed, it is just as likely to end up splitting the Union.

True, the opinion polls do suggest a degree of consensus across the EU about the desirability of aspiring to superpower status. But that raises the awkward question of how to deal with the existing superpower. Undoubtedly discussion of the United States in France on the one hand and Britain and Poland on the other has a different quality to it. British left-wingers may rail against “that cowboy Bush”, but they do not believe that America represents some sort of existential threat to their country, whereas in France that feeling permeates the debate.

Although some leading European politicians seized on the anti-war demonstrations to claim the birth of a European nation, others were much more sceptical. Jacques Delors, for example, dismisses the polling evidence as much less significant than the history and the deep structures which he believes bind Britain to America. Similarly, Hans-Gert Pöttering, the leader of the dominant centre-right group in the European Parliament, has said that: “Defining Europe in anti-American terms could destroy Europe.”

The enemy within

There is also the uncomfortable reality that rivalries between EU countries are often at least as serious as any rift across the Atlantic. Indeed, the European split over Iraq was arguably as much about a struggle for control of the EU as it was about Iraq itself. The Spanish government's decision to align itself with Britain and the United States reflected Mr Aznar's belief that his country had too often allowed itself to be dominated by a Franco-German axis within Europe. And when Jacques Chirac, the French president, lashed out at central European countries that supported the war, saying they had “missed a good opportunity to shut up”, he was reflecting French dismay at the realisation that in the newly enlarged EU the French cockerel might no longer rule the roost.

But it is not just rivalries within the EU that will continue to bedevil efforts to turn the Union into a coherent global power. It is also Europeans' continued ambivalence about the whole idea of exercising power on the world stage. Probe a little deeper into the apparent support in the opinion polls for the EU becoming a superpower, and it quickly becomes more ambiguous.

For example, Europeans are distinctly reluctant to spend more money on defence, and markedly unenthusiastic about using military force. The 2003 poll for the German Marshall Fund asked respondents whether they thought that in some conditions war was necessary to obtain justice. In America 55% agreed strongly that it was, but in France and Germany only 12% felt that way. These public attitudes are reflected in EU countries' low levels of deployable military force compared with America.

Some Europeans argue that the EU's opportunity lies in becoming a new sort of superpower, using economic weight and skilful diplomacy as a form of “soft power”. They point out that the Union has managed to bring about deep changes in the behaviour of its neighbours through EU enlargement. The carrot of EU membership is an extraordinarily effective foreign-policy tool; one Brussels official jokes that: “Once a country applies to join the EU, it becomes our slave.”

But it cannot be applied to countries without any European connections, and there is nothing much else in the toolbox. Eurocrats like to note, for example, that the EU spends far more on foreign aid than does the United States; but all the money that the Union has thrown at the Middle East, and the Palestinian Authority in particular, has done little to give the Europeans any leverage there.

Observers from outside Europe can sometimes shine a cruel light on the EU's pretensions. Max Boot, an American neo-conservative at the Council on Foreign Relations in New York, does not mince his words: “By the traditional measures of power, Europe is in decline: economic growth is anaemic, military budgets are in free fall, the fertility rate is declining.” He is putting his finger on a real problem. It is not just that Europeans are divided and reluctant to spend on military force; it is also that Europe's share of the world economy is shrinking as the United States constantly outstrips European growth and the Asian economies surge ahead.

Slow economic growth in the EU not only makes it harder to project European power. It also threatens the second pillar of the European project: the promise that European unity will deliver prosperity.

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Passport to prosperity

Sep 23rd 2004
From The Economist print edition

That was one of the EU's big attractions; but is it still?

Corbis

A mature perspective

WHAT do ordinary Europeans want from the European Union? The opinion polls provide an unambiguous answer: jobs. The heart of the Union is plagued by high unemployment. In the euro area—the 12 countries that have adopted the single currency—average unemployment is 9% of the workforce. European leaders may be preoccupied with high-minded tasks such as enlargement or drafting a constitution, but the voters' main concern is their livelihood. The early years of European integration were helped by rapid and sustained economic growth in western Europe, but recently growth has become slow and intermittent. This is undermining one of the chief arguments for European unity: a reasonable expectation of ever-growing prosperity.

In the 30 years from 1945 to 1975, west European countries that had been devastated by war rebounded with astonishing speed. From 1950 to 1960, German GDP grew at an average of 7.9% a year. The number of private cars in France and Germany increased 20-fold between 1950 and 1966. The spread of affluence and the rise of the consumer society became a familiar story across the western world, but growth in western Europe was even faster than in the United States. Average income in western Europe rose from about 40% of American levels in 1950 to just over 70% by 1973.

Chicken or egg?

Exactly how much of western Europe's economic development can be attributed to the merging of markets and the dismantling of tariff barriers that formed part of the drive for European unity is a moot point. Many economists think the EU has played a crucial role by creating a secure legal environment for business and enabling European companies to reap the economies of scale previously available only in the United States. On the other hand, it is striking that by the time the common market was established, almost half the miracle years of 1945-75 had already passed. Nonetheless, countries that had stood aside from the European experiment were soon casting envious glances at the economic success of the participants.

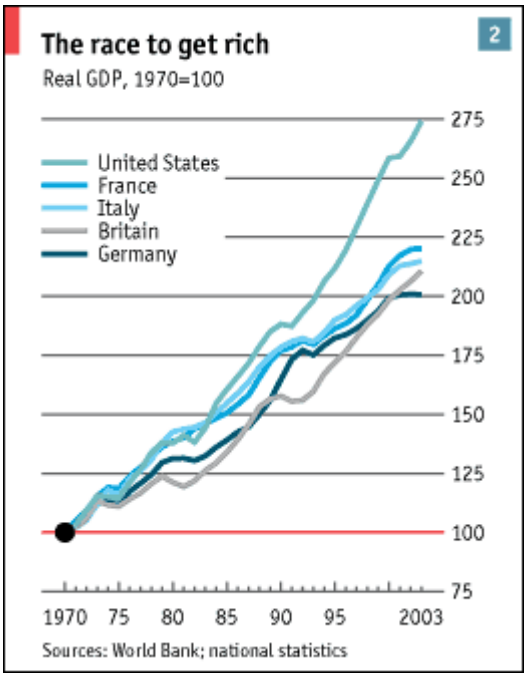
In his valedictory dispatch in 1979, Sir Nico Henderson, Britain's ambassador to France, pointed out that in 1954 Britain's GDP per person had been well ahead of France's and West Germany's, but by 1977 it had fallen 41% and 46% respectively behind those of its big neighbours. Sir Nico attributed much of this

relative decline to Britain's lack of enthusiasm for the process of European integration.

Britain did not join what was then the European Economic Community until 1973, along with Ireland and Denmark. Since then successive waves of enlargement carried the hopes of poorer European countries to achieve the wealth levels of “core Europe”.

For many new EU members, entry has indeed triggered rapid economic growth. The biggest success story is that of Ireland, where income per person was only 62% of the EEC average when it joined in 1973, but had reached 121% of the EU average by 2002. However, other late entrants have also done well. Spain, a much larger country, has emerged from the poverty and isolation of the Franco era and is now one of the fastest-growing and most dynamic countries in Europe. The eight central European countries that joined the EU this year have high hopes that membership of the Union will work its magic for them too.

But whereas some peripheral European economies boomed after joining, the core European economies that they sought to emulate began to stagnate. In Germany, France and Italy, the heart of the single-currency area, unemployment is now hovering around 10% and public finances are in a mess. Germany in particular has had a grim few years: since 1996, it has averaged growth of just 1.3% a year. In fact, western Europe's economic miracle ended a long time ago. Average income levels, having risen to 70% of America's in the early 1970s, have been stuck there ever since and are now declining in relative terms.



Efforts to re-launch the EU economy through bold reforms have mostly proved disappointing. The Single European Act, passed in 1986, was meant to light a bonfire of trade-restricting regulation and create a true single European market by 1992. The euro became a reality in 2002, launched in the hope that a single currency would spur trade, competition and ultimately growth. Yet neither the single market nor the single currency have yet fulfilled these hopes.

European policymakers are feeling glum. Guy Verhofstadt, the Belgian prime minister, recently summed up their mood: “Growth in Europe last year was 0.8%, in the United States it was over 3%, in China it was over 10%...If we don't change things, we risk turning Europe into a social and economic museum.” A senior EU economic policymaker, noting that America's productivity has once again begun to surge ahead of Europe's, muses: “Europe urgently needs to press ahead with structural reforms. It is unsustainable, year after year, to fall behind in GDP per head because you do not improve labour productivity.”

But are things really that bad? Some observers think that the sense of gloom in Europe is exaggerated. The Asian tigers may be growing much faster than the European economies, but then they started off far poorer. And much of the faster growth in the United States simply reflects the country's rapid increase in population: productivity per worker is actually fairly similar to that in the EU. Any remaining gap between Europe's and America's economic performance in recent years is due largely to problems in Germany, which is still trying to recover from the economic effects of unification. By contrast, some of the more peripheral European countries have done strikingly well. The World Economic Forum last year rated Finland as the world's most competitive economy, with Sweden coming third.

Perhaps, too, most Europeans have simply decided to enjoy some of their wealth in the form of leisure, rather than working ever longer hours, as the Americans do. Their economies may be growing more slowly, but their lives may be pleasanter. However, this theory of a European “preference for leisure” is controversial. Some experts believe that Europeans work less because they genuinely prefer to take time off; others argue that it is high taxes that discourage people from working and creating

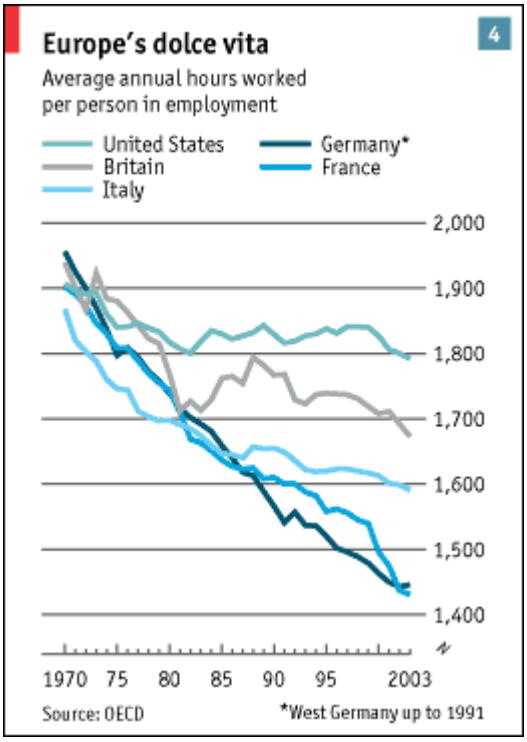
jobs.

But this beauty contest between the American and European models is ultimately beside the point. Miss Europe and Miss America may each have their admirers, but Miss Europe is at a huge disadvantage because she is growing old far more rapidly. Because Europe's society is ageing, the EU's real economic problems are yet to come. Suppose, for the sake of argument, that Europeans collectively have indeed made a choice to accept lower economic growth in return for more social protection and leisure time—the so-called "European social model". The trouble with this model is not that it is illegitimate, but that it is unsustainable.

An old problem

At present, the EU has 35 people of pensionable age for every 100 of working age. But Europeans are not having enough children to replace today's workers. A Deutsche Bank report in 2002 calculated that, on current demographic trends, by 2050 there will be 75 pensioners for every 100 workers in the EU. More immigration might ease the problem, but the numbers needed to offset the effect of ageing would probably be politically unacceptable.

State pensions in the EU are mostly paid for out of current tax revenues, so either taxes or national debts, or both, may have to rise steeply. In a recent report on the fiscal implications of ageing in Europe, Standard & Poor's, a credit-rating agency, predicts that the EU countries with the most serious pensions problems—including France and Germany—could see their public debt grow to more than 200% of GDP by 2050. For comparison, countries that want to join the euro are supposed to keep their public debt below 60% of GDP.



EU policymakers realise that something has to give. According to an authoritative report commissioned by the EU and led by André Sapir, an economics professor at the Free University of Brussels, "The current combination of low growth and high public expenditure is not sustainable and will become less so in the future." As the Sapir report makes clear, the major European economies have become locked into a vicious circle: low growth has led to higher unemployment, which has led to higher social expenditure, which has led to higher taxes and thus to lower growth. It states bleakly that: "The sustainability of the European model(s) of development is increasingly challenged, without a viable alternative in view."

The EU's demographic problem is worsened by the number of working-age Europeans relying on welfare. The unemployment statistics of 9-10% in the euro zone are just the tip of the problem. Much larger numbers of potentially working-age people are not at work but are drawing some sort of welfare benefit, perhaps because they are single mothers or are classified as disabled or have retired early. In the Netherlands, for example, around 1m out of a working-age population of less than 9m are now classified disabled, many with psychological ailments.

Raymond Torres of the OECD, an economic think-tank, reckons that around 40% of Europeans of working age are economically inactive, compared with 29% of Americans. He says that Europeans must get more people back to work, both by raising the pension age and by reducing welfare rolls. The alternative is that "welfare systems will collapse and there will be a forced and chaotic reduction of benefits."

There is hope that it may not come to that. Already calls for structural economic reforms have become a staple of European politics, and even some of the trade unions are becoming more realistic. Big German

employers such as Bosch, Siemens and DaimlerChrysler have recently negotiated agreements to extend working hours without increasing pay, which should sharply increase productivity. The enlargement of the EU, and the knowledge that just across the border there are workers willing to do the job for far less money, has clearly acted as a spur to reform.

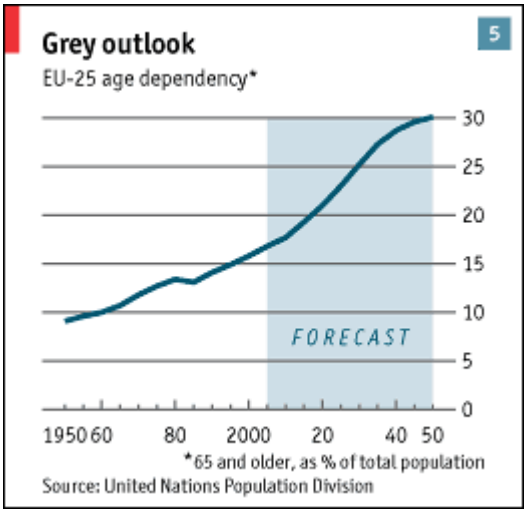
Some European governments have introduced successful policies for getting the unemployed back to work. In Britain and Denmark the ratio of the population at work is higher than in America. Such successes have spurred other European governments to try harder. Gerhard Schröder, the German chancellor, has pushed through a package of reforms, including the first cuts in the level of unemployment benefits in Germany since 1945.

Reasons for doing nothing

But reform remains fearsomely difficult. Mr Schröder's reward has been to see his party slump in recent regional elections, and to be told by economists that his efforts are inadequate. The political climate elsewhere is equally discouraging. In Italy, the government of Silvio Berlusconi recently had to call a vote of confidence to force through a reform to raise the country's retirement age. In France, nobody has attempted a bold pension reform since the government of Alain Juppé was fatally damaged by street demonstrations in 1995. The memory still lingers.

But however menacing the demographic time-bomb may be for Europe, is it really a problem for the EU? After all, welfare and pensions are still run by national governments, not by the EU—and it is those governments that will be punished at the ballot box if things go wrong.

All the same, the EU is unlikely to escape the consequences. It has deliberately tied together its members' political and economic fates. Twelve EU countries now share a currency, and all 25 members are linked by a dense network of economic and social policies. If economic problems mount, so will political tensions among EU members.



These tensions could be most serious inside the euro zone (see article), but some consequences of a deteriorating economic climate will be equally felt by all EU members. In particular, this is likely to affect the direction of economic policy. Over the past few decades, EU countries have united behind big joint projects such as the creation of the internal market. But different countries have interpreted the “single market” in different ways.

The British complain that it has been introduced with too much Brussels-inspired regulation attached to it, and call for further and faster market-opening and less red tape. The French grumble that the internal-market programme has promoted “liberal Europe” at the expense of “social Europe”. They want to redress the balance by introducing more Europe-wide social legislation on such things as workers' rights and minimum wages. The Germans, for their part, fret that zealots in the European Commission have been hurting German industry, and are campaigning for less onerous environmental legislation and a more relaxed attitude to state subsidies. A new element has been added by the arrival of the new central European members, who are anxious to preserve their competitive advantages: low wages, low taxes and light regulation.

Historically, the genius of the European Union has been that it has managed to accommodate and contain such different traditions and priorities. But things could soon get much more difficult. Enlargement has greatly added to the diversity of the EU. How do you design rules that make as much sense in Sweden as they do in Slovakia? One answer would be simply not to try. But the EU has a terrier-like record of never retreating from any policy area that has become part of the *acquis communautaire*, the body of laws, rules and regulations agreed on by the member countries.

The clash between the different political philosophies within the EU could also become sharper in the next few years. The French and the Germans, for example, have made it clear that they would like the EU to do more to develop a pan-European “industrial policy”. Yet that would be anathema to the market-based policies on competition and state aid that have in recent years been pushed by Britain and indeed by the European Commission itself.

When economic times are hard, such problems become more difficult to gloss over. In the past, with a prosperous Germany at the heart of a self-confident Union, many tough problems were eventually resolved by the German government reaching for its cheque book. In the 1960s, as European integration got going, the Germans agreed to the common agricultural policy, a baroque system of farm subsidies that has always benefited France disproportionately, almost as a form of war reparations. In the 1980s, when Spain and Greece hesitated to agree to the single market because they feared their industries could not cope with the competition, huge EU regional-aid programmes, again underwritten by Germany, smoothed the way.

But modern Germany is no longer willing or able to be this generous. Other traditional big payers such as the Dutch are also in a much meaner mood. The next EU budget round, which starts in earnest later this year, will be extremely tricky.

The real risk, however, will not be that EU negotiations become harder. It will be that European citizens, facing difficult economic times and the erosion of their much-loved “European social model”, decide to put some of the blame on the Union itself. The opinion polls already make troubling reading. The latest Eurobarometer polls, taken in the 15 countries that made up the EU before enlargement, asks, “What does the EU mean to you personally?” Although the EU's most far-reaching powers are over the economy, “prosperity” came way down the list, cited by 19% of respondents; more (26%) said the Union was a “waste of money”.

On the main economic issues facing the EU—fighting unemployment, containing inflation and protecting pensions—those that give it good marks are outnumbered by the critics. The strains of reforming the “European social model” could exacerbate what is perhaps the EU's most profound problem: the lack of genuine popular support for “ever closer union”.

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One for all

Sep 23rd 2004
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The perils of a single currency

EPA

Watch out for free-riders

MANY predicted chaos when the euro was launched on January 1st 2002. Withdrawing 12 national currencies simultaneously and replacing them with a new single currency was fraught with logistical and political risks. In the event, the transition to the euro went like clockwork. Watched over by its guardian, the European Central Bank (ECB), the new currency swiftly established itself with consumers and the international money markets. It has become the single most powerful symbol of European unity.

But as the old joke goes, whereas the euro clearly works in practice, there are still question marks over whether it works in theory. Theoretical doubts about the euro have almost always centred on the long-term problem of maintaining a single currency without a single government behind it. The early years of the euro have not yet answered these questions: if anything, they have made them more intriguing—and troubling.

When an individual country runs into financial problems, it may be faced with high interest rates, a threat of inflation and a run on its currency. But when a number of independent countries share a currency, the risks are spread, so some countries may become "free-riders". Even if they fail to tackle their own fiscal problems, they may escape the full consequences of their lack of action—but only because other, more responsible countries pick up some of the tab.

It was this prospect that persuaded the EU to draw up a "stability and growth pact" which required all euro countries to keep their budget deficits below 3% of GDP at all times, on pain of huge fines for repeat offenders. Unfortunately the pact proved unworkable. Portugal, the first country to exceed the 3% deficit, obediently slashed public spending, thus deepening its recession and pushing up unemployment. But when France and Germany broke the 3% barrier, they leant on the other EU members not to enforce the pact. In effect, despite a ruling by the European Court of Justice, the stability and growth pact is now in abeyance.

But the "free-rider" problem remains unresolved. Indeed, it is likely to become increasingly troublesome as the ticking of the demographic time-bomb becomes louder. It may not be entirely coincidental that the three EU countries that have chosen to stand aside from the single currency for now—Britain, Sweden and Denmark—have gone further than most to put their pensions systems on a sound financial basis.

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No love lost

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From The Economist print edition

The EU is becoming ever bigger and more powerful—and ever less popular

GettyImages

Pandora's box?

"THIS is what you have to do if you want the people to build statues of you on horseback in the villages you come from." Valéry Giscard d'Estaing was trying to stiffen the resolve of his 12 colleagues on the committee that was drafting a constitution for the European Union. He was doubtless joking, but the joke made a serious point. European unity has been driven forward by people such as Jean Monnet, Robert Schuman, Jacques Delors and Mr Giscard d'Estaing himself (all of them French, as it happens).

Many of the "founding fathers" of European unity emerged from the second world war with a profound suspicion of populism. Germany has consistently refused to hold referendums on crucial steps towards European unity such as the euro, citing Hitler's misuse of referendums as a reason for leaving such decisions to elected politicians. Some committed Europhiles frankly acknowledge that, at times, they have deliberately disguised quite profound changes as mere technical adjustments to avoid causing popular alarm. Jean-Claude Juncker, the prime minister of Luxembourg and the EU's longest-serving head of government, explains: "We decide on something, leave it lying around and wait and see what happens. If no one kicks up a fuss, because most people don't know what has been decided, we continue step by step until there is no turning back."

Carried to extremes, such an approach could be sinister and undemocratic. But those in favour of an elite-led Europe point out that all these decisions are made by elected leaders. If ordinary voters object, they can always take their revenge at the ballot box. But the hope is that each step towards "ever closer union", although potentially controversial at the time, will eventually come to seem inevitable and a good thing.

In many ways this method has worked. Plenty of European Union policies seemed visionary, or even reckless, when first suggested, but have come to be accepted with the passage of time: the abolition of frontier controls, the establishment of a single currency, even the admission of relatively poor countries such as Spain and Portugal in the 1980s or Poland today.

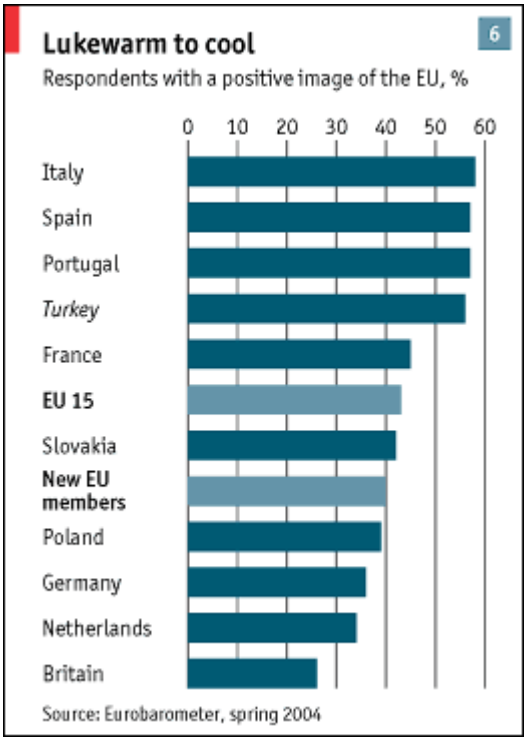
Visionary leadership is all very well if the statesmen get it right. But if they make a big mistake without having first secured popular backing, they could be in deep trouble. And even if voters are prepared to accept individual steps in the process of European integration, they may eventually object to the cumulative effect.

A transformation too far?

Step by step, the EU has expanded its frontiers and its activities so that in its present shape it is unrecognisable from the modest coal-and-steel community of the early 1950s. Whether or not the EU is intent on turning itself into a "United States of Europe", as some critics claim, it has already acquired a great many state-like characteristics: a currency, a central bank, a parliament, a civil service, a supreme court, a military staff, a diplomatic corps, even a flag and an anthem.

So far, it has managed to do all this without exciting much popular opposition. No national government in the EU has ever lost power because of an electoral revolt against European

integration. Even so, there is growing evidence that Euro-fatigue and Euroscepticism are spreading from traditionally critical members such as Britain to countries that used to be much keener on the European project.



Nearly half a century after its birth, the EU's approval ratings remain pretty feeble. In the most recent Eurobarometer, just 43% of EU citizens said they had a positive image of the Union, against 21% with a negative image. Even in Germany, one of the weightiest founder members, only 39% thought the country had benefited from EU membership, against 38% who thought it had not. A previous Eurobarometer found that almost half of EU voters would not mind, or indeed would be “very relieved”, if the EU were simply to disappear.

Evidence from the ballot box is not much more encouraging. Sweden and Denmark both voted in referendums against adopting the euro. (Most countries embraced the euro without a referendum.) Even Ireland, which has arguably benefited more from EU membership than any other nation, initially voted to reject the Nice treaty that paved the way for EU enlargement, and had to stage a second referendum before coming up with the “right” answer.

Recent elections to the European Parliament have not been heartening either. Although the parliament has steadily gained more powers over the years, voter turnout has fallen equally steadily. It reached a new low of 45.7% in the elections in June this year; not bad, perhaps, by anaemic American standards, but much lower than in national elections in Europe. The parliament was meant to connect the EU directly to the European public, but most European parliamentarians remain much less well known than national politicians. Moreover, there may be no institutional fix for the EU's “democratic deficit”, because there is no real European *demos*—a population with a sufficiently strong European identity to breathe life into common democratic institutions.

A comparison with the United States of America clearly shows up where a putative United States of Europe is missing out. America has a common language, national media, a national identity forged through a couple of centuries of shared history and a population that is famously willing to move from state to state. None of this applies to Europe. According to one EU survey, about half of all citizens of the pre-enlargement Union speak only their mother tongue. That rules out any real pan-European media, which in turn ensures that political debate across the EU remains staunchly national. And although almost all barriers to Europeans working or studying across the Union have been removed, most EU citizens remain determined homebodies: only 1.6% of them live permanently in an EU country other than their own. No wonder that national identities remain much stronger than any loyalty felt towards the EU.

So what?, ask the defenders of the EU. The whole point of the Union is that it does not pose a threat to national identity. Instead, it is a forum for European countries to co-operate in, while preserving their national identities and democracies. Yet even some of the architects of European unity are beginning to wonder whether integration has been overdone. In a recent speech in Berlin, Ben Bot, now the Dutch foreign minister and before that one of the longest-serving ambassadors in Brussels, argued that the EU had developed too fast for many of its citizens, causing many of them to fear a loss of national identity and yearn for the “familiar old world, the nation state”.

Individual member countries worry about different aspects of the EU. In Austria, Euroscepticism has been fed by the rules on free movement of goods, which allow endless convoys of huge lorries from other EU countries to grind across fragile Alpine passes. It may seem petty, but many Austrians feel that the EU is threatening the very look and feel of their country. In France, people are concerned that an organisation invented by French statesmen, and until recently largely francophone and run on French administrative lines, has been captured by the dreaded Anglo-Saxons. Rather than serving as a bulwark to preserve French culture and influence, the EU is now being portrayed as part of an assault against them.

Yet there is also a more general problem with the political underpinnings of the EU. The steady advance of European integration has taken the EU into some of the most sensitive areas of national politics, at precisely the time when the traditional justifications for European union—peace and prosperity—have become less compelling.

Bones of contention

In their day-to-day interactions with government—in schools, hospitals or welfare offices—most Europeans are still dealing with national rather than European institutions. But the creation of the euro, with a single interest rate and monetary policy for the euro area, has put the EU at the heart of economic life. It has also made national budgets subject to EU supervision: Portugal imposed swingeing budget cuts at the behest of the EU, and Italy may be about to do the same, despite the weakening of the stability pact.

The regulations introduced to make the single market work have also sometimes delved deep into what the British call the “nooks and crannies of everyday life”, occasionally making the EU an object of scorn and anger. British market traders have been prosecuted for failing to introduce metric weights and measures, as required by EU law. Dutch window cleaners were outraged to discover that their standard ladders were too long to comply with EU health-and-safety regulations. Such feelings are exacerbated by the widespread belief that EU institutions and spending programmes are corrupt and wasteful.

EPA

Waiting for a common immigration policy

Over the past decade the European Union has also increased its hold on social policy, leading to a clash of political philosophies between free-market Anglo-Saxons and welfare-minded continentals that can leave both sides unhappy. It is an article of faith in France that Britain practises “social dumping”, undermining French industry by refusing to impose decent minimum standards on employers. The British, for their part, are convinced that the French and the Germans, finding themselves unable to reform their welfare systems, are seeking to impose their own inefficiencies on everybody else through EU regulations.

The expansion of the EU into foreign policy has broadened the scope for disagreements and bitter feelings, as demonstrated over Iraq. And the “progressive framing of a common defence policy” promised in the new EU constitution could, in time, become equally contentious. Historically neutral countries such as Ireland and Sweden were given an opt-out from the defence aspects of the European Union, but that may not be enough to allay concerns about the “militarisation of the EU”.

The new European constitution also gives the EU a role in what may now be the most fraught political issue in Europe: immigration. Over the past 30 years immigration from developing countries, and particularly the Muslim world, has changed the face of western Europe. The number of Muslims in France is estimated at 4.5m, or about 7.5% of the population. In the Netherlands' four biggest cities—Amsterdam, Rotterdam, The Hague and Utrecht—the majority of those under 14 are the offspring of immigrants from non-western countries, most of them Muslim. Such striking social changes had provoked political reactions even before September 11th 2001 and the al-Qaeda attack on Madrid this year. But the terrorist threat has made race relations in Europe worse and fuelled the rise of anti-immigration and far-right parties.

In Austria, the Freedom Party led by Jörg Haider managed to force its way into a coalition government. In France, Jean-Marie Le Pen, the leader of the far-right National Front, came second in the presidential election of 2002, eliminating the socialist candidate. In the Netherlands, Pim Fortuyn caused something of a political revolution by running on an anti-immigration ticket in the 2002 election before he was assassinated.

Might the EU itself aggravate this anxiety about immigration? Any commitment to admitting Turkey may get a hostile reception in Austria, France and the Netherlands, mainly because of the likely consequences for immigration. The new European constitution could also cause trouble because it gives the EU the beginnings of a common immigration policy, in particular through common rules governing political asylum. This matters because in recent years most new immigrants from the developing world in countries such as Britain and the Netherlands have been asylum-seekers. Although there is no provision in the constitution for European countries to lose control over the level of immigration they are prepared to accept, such nuances may be lost in any referendum campaign.

Eleven countries have already promised to let their people vote on the European constitution. These referendums could throw the EU into the sort of crisis that puts the integration process into reverse or even causes the EU to split.

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Europe à la carte

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With many more members and increasingly diverging interests, a one-size Europe may no longer fit all

GettyImages

Where it all began

“GENTLEMEN, you are trying to negotiate something you will never be able to negotiate. But if negotiated, it will not be ratified. And if ratified, it will not work.” Those were the words of the British representative at the negotiations from which the European Economic Community eventually emerged in 1957. Nearly four decades later the British were still sceptical about European integration. Writing in *The Economist* in 1993, John Major, then Britain's prime minister, derided efforts to form a single currency as having “all the quaintness of a rain dance and about the same potency”. Wrong again.

Given this long British record of lofty and mistaken predictions that European integration cannot work, a British newspaper should be especially cautious in expressing scepticism about the future of the European Union. Yet to this writer at least, it does indeed seem that the EU is about to enter a particularly troubled period. It still seems highly unlikely that the Union will collapse. What is much more probable is that it will split.

The likeliest immediate cause of a split in the Union would be a failed effort to ratify the EU constitution. But the ground would have been prepared much earlier by the developments described in this survey: the waning of the forces that originally propelled the drive for European unity; the growing diversity of views and interests introduced by EU enlargement; and the increasing difficulty of maintaining popular support for the European project as the EU's powers expand.

Just how much new power the constitution gives the EU remains a matter for debate. It clearly does increase the EU's say in sensitive areas such as immigration and criminal law. It also strengthens the Union's foreign-policy role and puts down a marker for the development of a common defence policy. Moreover, the constitution includes a detailed charter of fundamental rights, which could mean that the European Court of Justice will play an increasing role in defining social, political and economic rights across Europe. It also advances EU powers in many other small ways, for example by creating an explicit EU role in the promotion of sport and tourism for the first time.

Some defenders of the constitution nonetheless insist that it is not a very radical document, certainly compared with the Single European Act of 1986, which set up the single market, or the Maastricht treaty of 1992, which created a single currency and a common foreign policy. That is probably true, but it may be beside the point. Countries such as Britain and the Netherlands did not hold referendums on the internal market or on Maastricht, so a vote on the constitution will be the first opportunity for their voters to express their cumulative misgivings about what the EU has become. Even in France, which did have a referendum on Maastricht, voters may still take the opportunity to voice discontent with recent

developments in EU policy—say the European Commission's “ultra-liberal” economics, or the unpopular promise to admit Turkey to EU membership.

Eleven of the 25 EU countries—Belgium, Britain, the Czech Republic, Denmark, France, Ireland, Luxembourg, the Netherlands, Poland, Portugal and Spain—have now promised or all-but-promised to hold referendums on the constitution, and even Germany is thinking about it. For most of the countries involved, this desire to consult the people about European integration is new, and itself reflects growing uneasiness about the popularity of the European project.

The constitutional referendums will carry a heavy risk for the EU. In theory at least, if even a single country refuses to ratify the treaty the constitution cannot come into force. But as Giuliano Amato, a vice-president of the constitutional convention, puts it, “Legally we could not proceed, but politically we could not stop.” It is difficult to imagine more than a score of EU members meekly abandoning a political project to which they have committed so much energy just because one or two countries have turned it down. For the moment they have simply agreed that if there are problems with ratification, EU leaders will meet in two years' time and decide what to do next.

Leaving some wiggle-room is probably wise, because much would depend on how many countries had rejected the constitution, and who they were. The biggest question marks hang over Britain, Denmark, France, the Netherlands, the Czech Republic and Poland, but at the moment the outcome is impossible to forecast. For example, the latest polls would suggest an easy victory for the “yes” camp in France, where opinion is running 2:1 in favour of the constitution, and a big defeat in Britain, which is split roughly 2:1 against. But French supporters are palpably nervous, recalling that the Maastricht treaty only just squeaked through with a “yes” vote of 50.5% in 1992. With the French socialists divided about the constitution, President Chirac unpopular with the electorate and the extremes on left and right likely to take a share of over 20% of the vote, a French “no” is certainly possible.

In the same way, Britain may change its mind. Europhiles there are currently deeply gloomy, but cheer themselves up by recalling that when Britain held its only other European referendum back in 1975, on whether to remain in the EEC, the “yes” camp started way behind and ended up winning by a respectable margin.

The outcome in the other battleground states is equally hard to call. The Danes have a record of rejecting European treaties in referendums, but seem to be bucking the EU trend by becoming less Eurosceptic. Poland was always deeply doubtful about the constitution; on the other hand, Polish farmers will soon begin receiving large cheques from the EU, which could turn opinion around. The Dutch have tended to be solidly in favour of European integration, but have been in a funny mood ever since Pim Fortuyn set off a wave of populism. The Czechs have no overriding grievance, but the country's president, Vaclav Klaus, is opposed to the constitution.

It remains possible that the constitution will be approved everywhere. For example, if sceptics such as Britain and Poland vote last, after a string of “yes” votes elsewhere, they may end up approving the constitution, fearing that otherwise they may have to leave the EU altogether. But it seems much more probable that one or more members will say “no”. What happens then?

From unity to division

If only one or two countries reject the constitution, they might simply be asked to leave the Union. There is already a lively debate in the French press about whether Britain should be thrown out if it votes against the constitution. But ejecting Britain (or any other country) might not be so straightforward. Under current EU law, Britain would have every right to insist on staying in the Union under the existing legal framework. And many of the smaller EU countries might be reluctant to see Britain leave because they see British influence as a valuable counterbalance to Franco-German dominance.

One outcome might be that Britain and other sceptics establish a semi-detached relationship with the EU. At one extreme this could be similar to the one Norway has negotiated. Norway is not a member of the EU and opts out of policies it dislikes, such as those on agriculture and fisheries. However, it is a member of the European Economic Area, which gives it access to the EU's single market. In return, it has to accept single-market laws on which it has no vote, and it also has to contribute to the EU budget. For Britain, a semi-detached relationship with the EU might be even more complicated. For example, as a major European power it might press for continued participation in EU summits and diplomatic activity.

If a larger number of countries said “no”, the EU could evolve into two blocks, with an integrated “political union” at its core and a looser economic union around it. The “core” countries would push on with integrationist projects that the British have traditionally rejected, such as the introduction of direct EU taxes and the establishment of an independent EU military force. They would also try to persuade Turkey to enter the looser economic “outer” Europe, which might include Britain, Poland and much of Scandinavia.

The most difficult scenario to predict is the aftermath of a putative French “no”. The French have always been so crucial to the EU that this would kill the constitution. That might bring about a sullen period of Eurosclerosis in which the EU remained in its current form but was increasingly by-passed by the bigger member countries in favour of bilateral deals, condemning it to increasing irrelevance.

Niall Ferguson, a British historian at Harvard, suggests that it might end up as just another big international organisation, like the International Labour Organisation in Geneva or the OECD in Paris. Alternatively, there could be a dramatic attempt to relaunch the EU and save the dream of European unity. In France itself, the political elite, already disenchanted with EU enlargement, has long fantasised about dissolving the present EU and starting again with a political union of the original six members; or perhaps just with France and Germany.

All these scenarios share a common factor: they envisage some sort of split in the European Union. Some observers find this prospect alarming. “Anyone with any knowledge of European history would be wary of seeing Europe split into rival camps,” says Oxford University's Timothy Garton Ash. The Iraq crisis provided a taster of how disturbing such a scenario might be. The sight of the German chancellor and the French and Russian presidents issuing joint statements on an international crisis sent shivers down a few spines in London and Warsaw. Mid-Atlantic meetings between the British and the Americans also stirred a few memories.

It is certainly conceivable that the European Union will split into rival, mutually suspicious camps, but the eventual outcome is likely to be messier and less frightening. Instead of two clearly defined alliances—an inner and an outer core, or an “old” and a “new” Europe—there will be a range of overlapping structures depending on the form of co-operation. Countries such as Germany, France and Italy are likely to belong to everything—the euro, the border-free area, the internal market and any future EU military force or judicial zone. Others, such as Britain and Denmark, will try to pick and choose, taking part in the single market and perhaps a new military structure, but avoiding monetary or judicial union and perhaps trying to slip out of participation in such areas as social or fisheries policy.

A Union of sorts

As it happens, this is the sort of European Union that has already been evolving over the past decade. The assumption that all EU countries would eventually join the euro has gradually eroded as first Denmark and then Sweden voted to reject membership of the single currency and a British decision moves ever further into the future. The passport-free Schengen area operates on a similar multi-tiered model: Britain and Ireland have stayed out and the central European countries have not yet been allowed to join, but Norway and Iceland, which remain outside the EU, are members of Schengen.

Lonely Planet

Can I see the menu?

The evolution of defence co-operation will further blur distinctions. Certainly as long as Tony Blair is

prime minister, the usually stand-offish British are likely to want to be part of an inner defence core. However, some countries that are members of the single-currency zone but traditionally neutral on defence matters—such as Ireland, Austria and Finland—will probably stay out. Attempts to impose a single economic model on the EU are also likely to stall. The central Europeans are determined to follow the Irish model of low taxes and light regulation and to fend off efforts to impose a Franco-German-inspired “European social model”. Under the current legal and political arrangements, they will probably succeed.

In the short term, a failure to ratify the constitution may actually disrupt the emergence of the multi-tiered European Union described above. In the long run, however, a constitutional crisis would confirm that the emerging European Union is simply too diverse to contain within a single uniform structure. The federalist dream of a “United States of Europe” will slide into irrelevance. A shell of an organisation called the European Union would probably be preserved, but some of its current members might even quit and negotiate new association agreements.

The result would be messy and hard to understand, and might cause new frictions. But it would also have two strong benefits. First, a more diverse EU would allow countries and their citizens to adopt different levels of European integration to suit their national preferences. Second, diversity would allow some useful competition between different economic and social models within Europe.

With peace and prosperity established, the European Union can safely abandon its old aim of an “ever closer union”. The new motto might be *vive la différence*.

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Telecoms

The marriage of two phones

Sep 23rd 2004
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New technology will abolish the difference between fixed and mobile phones

Get article background

IS THE fixed-line phone a dead duck? Look at the numbers and the trends, and you might well conclude that it is. Mobile phones now outnumber fixed ones, and their numbers are growing fast, while the number of fixed lines is flat globally and declining in many countries. An increasing number of people, including 5% of Europeans, are “cutting the cord” and going entirely mobile, doing away with their fixed lines altogether. And while fixed-line phones have hardly changed in years, mobile phones have many handy features, such as the ability to store dozens of names and numbers, not to mention text messaging and other services.

Yet fixed-line phones do have their advantages. Calls are cheaper and clearer, and connections are much more reliable, as anyone who has trouble getting a strong mobile signal indoors will testify. Hence the current enthusiasm throughout the telecoms industry for the idea of “fixed-mobile convergence”, which uses clever technology to provide the best of both worlds: the freedom of mobile and the reliability and low cost of fixed lines. Subscribers use the same handset to make calls via fixed lines at home, and mobile networks when out and about: they have one number and one voicemail box, and receive one bill.

Behind the scenes, this involves some clever tricks. Calls are handled within the home by a small base-station plugged into a fixed-line broadband-internet connection. This base-station communicates with nearby handsets using radio technology that operates in “unlicensed” spectrum, such as Bluetooth or Wi-Fi (so you will need a new handset). The base-station pretends, in effect, to be an ordinary mobile-phone base-station. As you enter your house, your phone “roams” on to it. When you make a call, it is routed over the broadband link, which has enough capacity to handle several calls at once by different members of the household. Calls made in this way are billed as fixed-line calls. If you leave the house while making a call, you roam seamlessly back on to the ordinary mobile network. And when a friend comes to visit, her phone roams on to your base-station, but the charges for any calls made appear on her bill.

Great expectations

For fixed-line operators such as BT, Britain's telecoms incumbent and one of the leading proponents of fixed-mobile convergence, the appeal of this approach is obvious: rather than losing out to mobile phones, fixed lines can now co-operate with them, and win back some traffic. After selling off its wireless arm a few years ago, BT has re-entered the mobile market by reselling airtime on other operators' networks; most recently, it has formed a partnership with Vodafone. A converged fixed-mobile service will enable BT to lower costs by shifting some mobile calls on to its fixed network; it will also allow the company to differentiate itself from mobile-only operators.

So-called integrated operators, which own both fixed and mobile networks—such as Germany's Deutsche Telekom and Japan's NTT—also like the idea of fixed-mobile convergence. They can save money by merging network infrastructures and doing away with separate fixed and mobile divisions. France Telecom, for example, is reorganising itself into consumer and business divisions, rather than fixed and mobile. And Cingular, an American mobile operator owned by two fixed-line incumbents, BellSouth and SBC, is pursuing convergence as a way to improve coverage within buildings, and thus exploit fixed networks to gain a competitive advantage over other mobile operators.

Even mobile-only operators are getting involved, and making deals with fixed-line providers. Fixed-mobile convergence could help them fill the excess capacity on their 3G networks, and enable them to unload calls on to cheaper fixed networks where possible, to reduce costs. In short, everyone in the telecoms industry seems to like the idea, because they hope it will expand the market overall. Once people get into the habit of carrying their mobile phones around with them at all times, even in the home, they will probably make more calls. Vendors love the idea too, notes David Brown of Motorola, the world's second-largest mobile-handset maker, because as well as requiring lots of back-end equipment, fixed-mobile convergence presents the opportunity to replace a billion or so existing fixed-line phones.

It all sounds great, which explains why the idea of fixed-mobile convergence has been around for several years. But it is only now gaining any traction. One reason, says Niel Ransom of Alcatel, a telecoms-equipment maker, is the success of mobile phones: fixed-mobile convergence only makes sense if everyone has their own handset, which they now do, in the rich world at least. It is also now possible to cram multiple radios (one for mobile use, and one for use within buildings) into a single handset without adding much to its cost or size. But perhaps most important of all is the emergence of technical standards. This month a consortium of operators and suppliers, including Alcatel, BT, Cingular, Ericsson, Motorola, Nokia, Nortel and T-Mobile, announced specifications for integrating wide-area mobile with short-range Bluetooth and Wi-Fi networks. An agreed standard means that operators can proceed without the risk of being locked in to a particular technology.

Most observers agree that BT is the operator to watch. In July it co-founded an alliance of operators called the Fixed Mobile Convergence Alliance, the other members of which include NTT, Brasil Telecom and Korea Telecom. BT's trailblazing fixed-mobile convergence technology, known as “Bluephone”, is being developed by a seven-company consortium that includes Alcatel, Motorola and Ericsson, and is being closely watched by other operators. “If I go anywhere in the world, and talk to any operator, they want me to tell them about Bluephone,” says Mr Ransom. “They've all got their eye on it, and they will all be watching BT very carefully to see how this works.” Now that technical standards have been agreed and handsets are becoming available, BT expects to start trials of Bluephone in December, in preparation for a launch next spring.

The big unanswered question is: do consumers actually want these new converged phone services? BT plans to market Bluephone on the basis that it is a simplifying technology, yet explaining exactly how it simplifies things is not easy. “Education is needed, and a focus on simplicity,” says Andrew Cole of A.T. Kearney, a consultancy. One way to think of fixed-mobile convergence, he suggests, is that it brings the features of mobile phones into the fixed environment. Market research shows that people are receptive to the idea, he says, particularly if it means lower prices.

If Bluephone proves a success in Britain, it is likely to trigger the launch of similar services elsewhere. Mobile-only operators may then rush to team up with cable operators in order to compete, since being a mobile-only or fixed-only operator will no longer be viable, says Lars Godell of Forrester, a consultancy. More companies might also follow the lead of France Telecom, and merge their fixed and mobile divisions. The historic distinction between the two types of telephones would vanish. If all of this comes to pass, the terms “fixed” and “mobile” could become anachronisms within a few years.

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Enron

Trial run

Sep 23rd 2004
From The Economist print edition

Enron's prosecutors face their first test

NEARLY three years after Enron's spectacular collapse into bankruptcy, the first criminal case involving the company opened this week. But in one sense, it is the Enron task-force of prosecutors acting for America's federal government, appointed in January 2002 to investigate possible criminal wrongdoing, who are on trial.

A number of former Enron executives, the most senior of whom is Andrew Fastow, once the energy giant's chief financial officer, have chosen to plead guilty to criminal charges in return for a promise of lesser sentences. Those now on trial are two former middle-ranking Enron employees and four former senior bankers from Merrill Lynch. (The bank itself avoided prosecution by signing a co-operation agreement with the Enron task-force.) The defendants say they are innocent of all charges, which include falsifying books and records. So for the first time prosecutors will have to convince a jury—one in Houston, Enron's home city—beyond reasonable doubt of their guilt. That means proving they acted with criminal intent, a requirement that makes convictions for white-collar crime hard to obtain.

The same stiff test will apply to charges of fraud and manipulating Enron's accounts brought against Kenneth Lay, the company's former chairman, and Jeffrey Skilling, its ex-chief executive. Both men deny all the charges. They are not expected to go on trial until next year, at the earliest.

The main issue in the trial which began this week is whether Enron, with help from Merrill Lynch, used a fraudulent scheme to deceive investors about the true performance of one of its businesses. This involved comparatively small amounts of money but it is a simple example of more complicated schemes, involving much larger sums, which the prosecutors allege Mr Lay and Mr Skilling used.

This week's case involves the apparent sale of assets—three electricity-generating barges in Nigeria—by Enron to Merrill Lynch, which increased Enron's profits by $12m and its operating cashflow by $28m. Although on paper Merrill Lynch appeared a genuine buyer, prosecutors claim that under a secret oral deal Enron promised a guaranteed rate of return and to buy back the assets within six months.

Because Merrill Lynch did not take any real risk from the apparent sale, the prosecutors say the deal should have been treated as a loan; hence neither the profit nor the operating cashflow should have been recorded on Enron's books. According to the prosecutors, the deal, concluded just as the firm's financial year closed in 1999, helped the Enron subsidiary involved to meet financial targets and Enron executives to earn bonuses.

A small part of the government's case against Mr Skilling is that he pushed through this transaction and knew that the secret side-deal was concealed from Enron's auditors. A guilty verdict would not of itself prove Mr Skilling's guilt, but if prosecutors are unable to win a conviction in this relatively simple case, that might not bode well for the more complex trials of the bigger fish to come.

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The internet

Alive and kicking

Sep 23rd 2004
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Competition still exists on the web

JUST when you thought you knew the web, along come new competitors to keep things interesting. On September 15th, a new search engine called A9.com was unveiled by Amazon, the giant internet retailer. It repackages Google's search results, but with useful tweaks. Searches not only call up websites and images on the same page, but other references, such as Amazon's book search, the Internet Movie Database, and encyclopaedia and dictionary references. Moreover, it keeps track of users' search histories—an important innovation as search becomes more personalised.

Many had assumed the market was stitched up by Google and Yahoo! (who account for over 90% of searches), barring the expected entrance of Microsoft. Likewise, the market for online music seemed settled: Apple's iTunes is the leader, its main rivals being RealNetworks and Microsoft's MSN Music. Yet this, too, understates the potential for battle. Last week, Yahoo! bought Musicmatch, an online music retailer and software firm, for $160m. Music downloads are now worth roughly $310m annually but are forecast to grow to $4.6 billion by 2008, according to Forrester Research, so there is room for new firms to sprout.

Meanwhile, the most surprising new competition is in web browsers. Microsoft was the undisputed champ, after bundling Internet Explorer with its Windows operating system in the 1990s and destroying Netscape. However, Microsoft's browser is so vulnerable to attacks by online crooks and various troublemakers that the American and German governments have recommended that users consider alternatives. This has been a boon to two small browser-makers, Opera, a Norwegian software company, and Mozilla, which developed the Firefox browser based on an open-source version of Netscape. Firefox boasted 1m downloads within 100 hours of its release on September 14th.

Security has become the main competitive difference. The software of both Opera and Mozilla is considered safer (partly because they have fewer users and so are a less attractive target for hackers). Microsoft's share of the browser market has actually shrunk over the past three months from around 96% to 94%. It is a highly symbolic phenomenon, albeit a modest decrease. Even Google is thought to be toying with the idea of launching its own browser.

Underlying this ripple of competition is the ability of large companies that already benefit from economies of scale to extend into new areas, says Hal Varian, an economist at the University of California at Berkeley. That explains Amazon's A9 search service and Yahoo!'s move into music. As for browsers, “Microsoft had a lock on the market and just dropped the ball. Microsoft hasn't provided any innovation in the browser area and they had poor security,” he says. The message: watch your back.

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The car industry

Stuck in the rough

Sep 23rd 2004
From The Economist print edition

America's car giants, General Motors and Ford, find Europe hard going

Get article background

WHILE Europe's golfers were thrashing America in the Ryder Cup last week in Detroit, Europe's carmakers were making life a misery for Motown's finest, General Motors (GM) and Ford, on the other side of the Atlantic. At the Paris motor show, which opens on September 25th, those with the most to boast about will be the marketing executives tending the stands of Renault and PSA Peugeot Citroën. These French companies have raced back from near-death in the late 1990s. Peugeot has been making some of the highest returns in the volume car business and a resurgent Renault has set industry standards, not least from its alliance with—and rescue of—Japan's Nissan.

The European subsidiaries of GM and Ford have seen their margins and market-shares squeezed. Now they face Japanese factories in Europe hitting their stride: Toyota, for one, has plans to double its 5% share of the European market.

For most of the past two decades the profits earned by GM and Ford in Europe helped to keep their parent companies in America afloat. Today Europe is the problem and turn-around plans never quite come off. GM made matters worse when it bought 20% of Fiat Auto, then worth some $2 billion, before it realised how troubled the Italian car firm was. GM is wriggling to get out of an obligation to buy the rest of Fiat Auto if the parent company's shareholders insist on selling.

This week the new boss of GM Europe, Fritz Henderson, gave himself 60 days to come up with a rescue plan for the company's Opel and Saab subsidiaries. They are making big losses, despite factory closures. GM has some successful models, such as its new Astra small car, but its much-vaunted big Signum saloon is a flop.

Saab struggles on with a tiny clique of fans for its two rather boring models; its output of around 120,000 cars a year is hopelessly uneconomic, especially as it still maintains its own design and engineering facilities. Sooner or later GM is going to have to close either a Saab plant in Sweden or an Opel one in Germany. At least Mr Henderson, contemplating his awful inheritance, seems inclined to follow the first law of holes: stop digging.

Ford is ahead of him in that respect. After closing its historic Dagenham factory in England and revamping its continental plants to make them flexible, efficient and capable of high quality, it is turning to the overpriced brands it bought in Europe: Jaguar, Land Rover, Volvo and Aston Martin. Only Volvo makes real money, but not enough to offset the others' losses. Ford recently decided to close Jaguar's Brown's Lane factory in Coventry, England.

So far, Jaguar has swallowed over £3 billion ($5.4 billion) since it was bought by Ford in 1989. It only ever made steady profits in the mid-1980s, when the dollar was strong against the British currency. Now that the dollar is weak, Jaguar is piling up losses in America, its biggest market, because its cars are both expensive and dull.

Jaguar's revival was pinned on developing a wider product range to boost output to 200,000 cars a year. But it can sell only around 120,000, which is not enough to justify three factories. Ford is also getting tough with Britain's Land Rover. It recently gave the workforce at Land Rover's Solihull plant an ultimatum: adopt modern, flexible working practices and give up old habits such as eating and smoking on the job, or the factory closes. If the dollar stays weak, Ford will have to start making Jaguars and Land Rovers in America—just as Mercedes and BMW already do for some of their models.

Meanwhile, France's champions are keen to drive further abroad. Renault and Peugeot both work their flexible French factories flat out rather than expanding them. Both reckon the future for European carmaking lies in places such as Slovakia and Romania, where labour costs are low. Within the next few years, Renault will use its partner Nissan to re-enter the American market for the third time, and Peugeot, which has broken out of Europe with its big footholds in Brazil and China, will probably follow. How the French fare in their American rivals' backyard will reveal just how good the Europeans really are.

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Advertising

Predator to prey

Sep 23rd 2004 | PARIS
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Can Havas remain independent?

ALAIN DE POUZILHAC, the chairman of Havas, a leading French advertising agency, pulled out all the stops to buy Grey Global, an American rival. The two firms would have been a good fit, but last week Havas lost the battle for Grey to WPP, a bigger British-based competitor. This leaves Havas a weak number six in an industry increasingly dominated by giants.

Mr de Pouzilhac was handicapped. His company's finances are fragile, with net debts of €800m ($972m) and €660m in convertible bonds due in 2006. Despite keen interest in Grey from a number of American private-equity firms, he failed to convince any of them to join his bid. And he faced opposition from his new big shareholder, Vincent Bolloré, a French industrialist and corporate raider. Mr Bolloré was against the idea of taking over Grey.

Havas now has to go it alone in a consolidating industry. The American firms Interpublic and Omnicom, together with WPP and Publicis of France, now dominate the advertising and marketing industry (see chart), on both sides of the Atlantic. Havas trails behind in sixth place. The trend towards bigger, more international firms is partly driven by client demand. Earlier this year HSBC, a big bank, chose WPP out of four competing agencies to handle its global advertising and marketing. Similarly, South Korea's Samsung Electronics will soon decide who will deal with its international advertising budget. And Nestlé, the world's largest food firm, will pick just one or two agencies to do all its media buying, adland jargon for negotiating advertising rates.

Analysts at Sanford Bernstein, an investment-research firm, think the industry is dividing and that some firms will continue to employ a roster of competing agencies while others follow the single-agency route. Procter & Gamble, the world's largest consumer-goods firm, employs agencies in each region to tailor its advertisements to local cultures. Coca-Cola and McDonald's are doing the same.

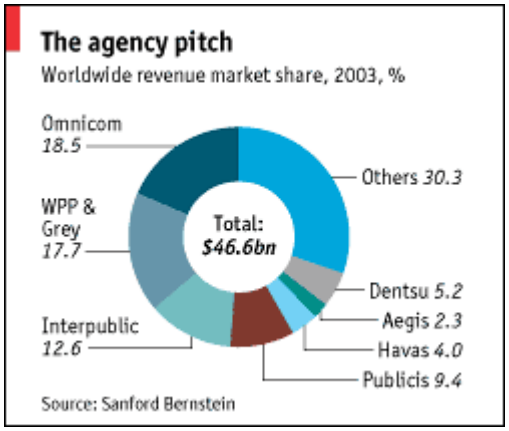
Mr de Pouzilhac thinks his firm can remain independent by shining with first-class service rather than impressing with scale. (Procter & Gamble is one of his clients.) Big is not necessarily beautiful, he says. The restructuring of the group is finished—some 1,400 people have been sacked—and finances are improving. Havas reported a €14m profit for the first six months of this year compared with a loss of €58.2m in the same period last year. Mr de Pouzilhac is now turning to shareholders to reduce debts. On September 20th, Havas announced a €400m rights issue.

Havas might benefit from WPP's takeover of Grey if either firm's clients now jump ship. After Interpublic bought True North in 2001, that agency lost the smaller firm's account with Pepsi because Interpublic worked for rival Coca-Cola. There is plenty of potential for client conflict with WPP and Grey. Colgate-Palmolive, Cadbury Schweppes and Unilever are WPP clients and rivals of Procter & Gamble, Grey's biggest customer.

Yet Havas remains vulnerable to a takeover. If the company weakens through the loss of a big client, it could quickly fall prey—just as Cordiant did when it was snapped up cheaply by WPP last year. Cordiant's kiss of death was the defection of Allied Domecq, a big drinks company.

But the wild card is Mr Bolloré, who now owns about 10% of Havas. He is already trying to make his mark on the company's management by pushing for a two-tier board structure. He wants to impose Pierre Dauzier, a Havas veteran, as head of a newly

created supervisory board and Thierry Marraud, the Bolloré group's finance director, as a member of a management board. And Mr Bolloré is not finished yet. On September 21st he announced his intention to increase his stake in Havas even further, although he said he does not seek control. At least, not yet.



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Unilever

Path to No Growth

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The harder way to sell consumer goods

NIALL FITZGERALD would have liked to leave Unilever in a blaze of glory when he retires at the end of September. The co-chief executive of the Anglo-Dutch consumer-goods group was one of the godfathers of Unilever's “Path to Growth” strategy of focusing on its brands, which was launched five years ago. But the plan failed to deliver on many of its promises. On September 20th, Unilever warned that it would not report its promised double-digit growth in profits this year.

It is a tough time for producers of branded consumer goods. Unilever and its competitors have to cope with pressure on prices and stiff competition from supermarkets' own brands. Colgate-Palmolive warned of lower profits on the same day. Nestlé recently disappointed investors with its latest results.

Even so, Unilever admits the bulk of its troubles are self-inflicted. The “Path to Growth” strategy aimed to make the firm more efficient. Unilever saved about €4 billion ($4.9 billion) in costs over the past five years and reduced its portfolio of brands from 1,600 to some 450. But it still failed to meet its targets for profit and sales, reporting a sales decline of 0.7% for the second quarter of this year.

Analysts think the main problem is under-investment in advertising and marketing, an infatuation with brands and unrealistic performance targets. Unilever cut its ad and marketing expenditure at the worst moment, says Andrew Wood at Sanford Bernstein, an investment-research firm. Commoditised products are especially vulnerable to the onslaught of retailers' own brands. In margarine, for instance, retailers' own brands now capture as much as one-fifth of the market. Unilever also over-extended some successful brands, for instance Bertolli's olive oils and pasta sauces. According to Mr Wood, Unilever can sustainably grow its business about 3% a year; it was shooting for 5-6%.

Rudy Markham, Unilever's chief financial officer, counters that consumers look for a product and then buy a brand, so his firm needs to focus on brands. Unilever intends to step up its marketing efforts, although ad spending is supposed to remain at current levels. At present, Unilever spends 14.5% of sales on ads.

But even Mr Markham admits the company has “issues of competitiveness”. After seven quarters of disappointing performance, it needs to regain credibility with investors. Over the next few months, management will rethink its strategy for the next five-year plan. Patrick Cescau, a Frenchman who will take over from Mr FitzGerald, is inheriting a tricky legacy.

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The reality-TV business

Litigious reality

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The bust-ups in television's blockbusters gets the applause of lawyers

Another show, another hopeful

WHAT is the difference—give or take a ridiculous hair-style—between Donald Trump's “The Apprentice” on NBC and Mark Cuban's “The Benefactor” on ABC? Or, with their liposuction and teeth implants, between “Extreme Makeover” (ABC) and “The Swan” (Fox)? Just as with sitcoms and police dramas, reality TV generates myriad copy-cat ideas and formulaic spin-offs—and therefore accusations of bad faith and plagiarism. But, with “Survivor: Vanuatu” (CBS) last week being watched by 20.1m Americans and “The Apprentice” by some 15.9m, plenty of viewers are happy enough.

So, too, are the lawyers. Simon Fuller, the boss of 19TV, ex-manager of the Spice Girls and creator and producer of Britain's “Pop Idol” and its spin-off “American Idol”, has lodged a suit for copyright infringement and breach of contract against Simon Cowell, a fellow Briton who, thanks to his brutally frank judgments on the talents of the contestants, is the star attraction of “American Idol”. The suit accuses Mr Cowell, his production companies and FremantleMedia (a co-producer of “American Idol”) of blatantly copying the Idol formula with “The X Factor”, which has just begun on Britain's main commercial network. The breach-of-contract charge apparently refers to a clause in “Pop Idol” contracts restricting the production team from working on rival shows.

Mr Fuller's case is basically that an original idea from which he has handsomely profited has been copied in a programme from which he will not profit. Earlier this month, Leigh Burton, a 33-year-old independent producer with none of Mr Fuller's clout, filed suit in Los Angeles alleging that her original idea had simply been stolen. She says that in August last year she conceived the idea of a reality-TV boxing series, and then in October and November reached an agreement with the boxing champion, Oscar De La Hoya, and his company Golden Boy Promotions. Negotiations, according to Ms Burton's lawyer, in January this year “reached an impasse”. Then, in March, Ms Burton learned that Mr De La Hoya and his company had made a deal with Endemol and Fox, culminating, two weeks ago, in the first episode of “The Next Great Champ”, hosted by Mr De La Hoya and with a world-title fight as the prize for the eventual winner.

Hence the lawsuit. This is not the show's only legal problem. At around the time negotiations between Ms Burton and Golden Boy were souring, Dreamworks TV was asking Mr De La Hoya to host “The Contender”, a reality boxing programme co-produced by Mark Burnett (originator of “The Apprentice”) for NBC. Angry that Fox had outsmarted it, NBC in August sought in vain an injunction to stop “The Next Great Champ”. The rumour now is that NBC will push the start of “The Contender” back from November to January, not least to avoid it being tainted by the poor ratings so far of the Fox show.

Arguably, lawsuits are just another cost of doing business in the reality-TV business. On the eve of last weekend's Emmy awards for achievement in television, one executive said bluntly: “We all have essentially the same ideas. It comes down to how you execute it.” Indeed so, which is why Ms Burton took care to prepare a “treatment” of her idea and register it with the Writers Guild of America.

How much that will help her case remains to be seen, though at least she has hired Bruce Broillet, one of America's best entertainment-industry lawyers. Mr Broillet says: “In order to win the ratings game, it appears that networks and producers are desperate to come up with fresh ideas at anyone's expense. They use their clout to lure new talent in and steal their ideas, with the end result being that the talent fears being blackballed by the industry if they object.”

In such a world the big boys, like Messrs Fuller and Burnett, can look after themselves. So, too, the networks, always ready to play hardball with each other. Fox, for example, copied ABC's “Wife Swap” (bought from a British idea)—but launched “Trading Spouses” in July, a profitable summer ahead of its rival's debut on September 29th. The networks know that in the absence of a script the law is imprecise and that any adverse judgment (of which there seems so far to have been none) would, in any case, come after any profits.

Will this ever change? David Lyle, a former president of entertainment and drama at FremantleMedia North America, has founded the Format Recognition and Protection Association to promote the idea that unscripted reality-TV contains intellectual property that should be protected by law. He notes that at the moment “the business is generally run as a series of gentlemen's agreements. Sadly, many people don't act like gentlemen.” Hmm. Cue for a new series: “The Gentleman”?

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Face value

The king of guanxi

Sep 23rd 2004
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Vincent Lo's career shows what it takes for an outsider to succeed in China

SIPPING tea in his penthouse office with sweeping views of Hong Kong harbour, Vincent Lo does not look the sort who spends too much time roughing it in mainland China. The 56-year-old's impeccably cut Mao-collared Blanc de Chine suit and designer haircut disguise a man who spends three days a week dashing between grimy cement plants and building sites in frantic Chinese cities. Yet over the past two decades, with a relatively modest outlay of $1.5 billion, the chairman of the Shui On Group has turned his building-materials and construction firm into one of the most consistently successful foreign investors in China.

When it comes to parlaying social connections into business opportunities few can match Mr Lo. His avowed desire is to contribute to China's success and not just his own profits. This has earned him the trust of many of China's elite—and a nickname: “the king of *guanxi* [connections].'' How he built his empire says much about the realities of doing business in China.

That Mr Lo was the son of a successful Hong Kong property tycoon helped only indirectly. Unwilling to join the family firm, he was something of a black sheep. His mother had to beg her husband to lend their son HK$100,000 ($16,700) to start a company. Desperate to prove himself, he took risks: going into Shanghai in 1984 when few others dared. Mr Lo built a hotel with the city's Communist Youth League. It opened as students rioted in Tiananmen Square, occupancy plunged and the league could not repay its construction loan. “I helped out,” says Mr Lo. “They've never forgotten. Relationships are long term here.”

One of those who remembered was Han Zheng, the Youth League secretary and now mayor of Shanghai. Along with Xu Kuangdi, a former Shanghai mayor with whom Mr Lo established some of the first business links between Hong Kong and Shanghai, the pair helped Mr Lo win his biggest coup. This was the right to develop a piece of land surrounding the hallowed hall where the Chinese Communist Party held its first meeting. The $170m Xintiandi project involved building a two-hectare complex of restaurants, bars and shops in an elegant low-rise style. Xintiandi is now a prime entertainment spot and one of Shanghai's—and Shui On's—most important marketing tools. Foreign heads of state, such as Russia's president, Vladimir Putin, queue up to dine at the Clubhouse.

Xintiandi has so delighted central government and Shanghai officials (Wen Jiabao, China's prime

minister, sometimes drops in for tea) that Mr Lo has won permission to develop an adjoining 50 hectares into luxury townhouses, offices and hotels. Although the project itself has produced pedestrian profits for Mr Lo, its halo-effect has enabled him to sell apartments there at high prices. And Xintiandi is proving a model for other aspiring cities in China. Mr Lo is building the next one, Xihu Tiandi, in Hangzhou, a city to the south-west of Shanghai.

But there is more to Mr Lo than property. Just as he was an early investor in China, he was also early to move inland from the prosperous coast. His political antennae told him that the country's leaders would be forced to develop the poor interior to balance explosive growth along the coast. And building needs cement. In 1995, five years before Beijing promulgated its “Go West” campaign, Mr Lo bought his first cement plant in Chongqing, a huge inland city. The timing was perfect; cement consumption has grown fast and Shui On is among the top three producers. Mr Lo believes he is unlikely to fall foul of recent measures to limit suppliers since he tends to buy up existing cement-makers rather than build new plants on greenfield sites. And he keeps local officials happy by promising not to fire workers.

His decision to invest in Chongqing was encouraged by the appointment of an old friend from Shanghai as the city's vice-mayor and later a former central-government minister as its party secretary. Mr Lo well understood that unless the interests of local and central government are aligned, foreign investors can get caught in the crossfire: Chongqing's previous mayor and party secretary had been at loggerheads. Reassured, he is now planning an urban redevelopment in Chongqing twice the size of Xintiandi. Wuhan, another inland city, will be next.

Seek no favours

That Mr Lo seems to have the run of China is partly explained by his extensive connections. An honorary citizen of Shanghai since 1999, he is also a member of one of the top advisory bodies consulted by central government. But he wears this network of *guanxi* lightly. Of his old Shanghai friend, Mr Han, Mr Lo says: “I've never asked him for any favours, that's why he is not afraid to see me.” And he understands that China expects a lot back. Adrian Ngan, a property analyst at BNP Paribas Peregrine, says: “No head of a Hong Kong company visits China as much as Vincent Lo. When China sees the chairman so often, they believe he is sincere.” Such intimacy built over decades can establish trust in an unpredictable business climate. Mr Lo's contract for the huge Xintiandi project was a mere six pages long. “Contracts in China allow for things to change,” he says, smiling at the legalistic mindset of most foreign investors who get bogged down in procedural detail. “Other developers scratch their heads and say ‘How can we cope?’ I see change as an opportunity, not a threat.”

Yet despite these advantages, it is not clear whether Mr Lo can consistently make a good return in China. Cement margins are under pressure and relocating residents to make way for new developments is getting more expensive. And it is likely to take years before investments in luxury property in dirt-poor places like Wuhan and Chongqing pay off. Meanwhile, Mr Lo would be hurt badly if there were a crash in Shanghai's property prices. But that is the risk he takes. After 20 tireless years he has the ear of some of China's most senior policymakers, and that is something many outsiders will find hard to beat.

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Japan's service economy

Dead firms walking

Sep 23rd 2004 | TOKYO
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Japan's unproductive service industries are holding back its improving economy from achieving even better performance

Get article background

FOR a country that boasts some of the best manufacturers in the world, Japan's service sector remains strikingly poor. In recent years precious little has been done to improve things—businesses and individual consumers must struggle with outdated and inefficient services. Yet the sector represents a huge opportunity for Japan. Reformed and galvanised, it could take up the slack of future economic slowdowns and lessen the burden on export-led manufacturing. Why are service industries so backward and what might be done to improve them?

For more than a decade after a financial crisis in 1989 plunged once-booming Japan into a long period of slow growth, weak companies and wobbly banks clung to each other in mutual defiance of reality. Troubled borrowers needed the banks to overlook their problems and keep open the flow of money; the banks, too short of capital to admit that their loans had soured, obliged. Over time, this led to the emergence of so-called “zombies”—companies that are competitively dead, but, sustained by their banks, continue to walk the Earth and give healthier firms nightmares. And zombies are most prevalent in the service sectors of the economy, especially construction, property and wholesale and retail distribution.

The unholy alliance between zombies and banks has proved one of the most durable, distorting and debilitating compacts in modern economic history. It has set Japan apart from other countries stricken with financial crises and greatly prolonged its economic suffering. Lately, however, there are signs that things are changing.

Consider, for example, the story of a dysfunctional duo that has been hogging Japan's headlines: UFJ Holdings and Daiei. UFJ is a troubled megabank that has gone to great lengths to avoid facing its problems. It received a dose of reality earlier this year, when regulators discovered a brazen attempt by UFJ managers to mislead them about the state of its loans. In order to put its books in better order, UFJ has since agreed to merge with Mitsubishi Tokyo Financial Group (MTFG)—Japan's best-capitalised megabank. But it has also done something almost unprecedented: it has threatened to call time on its worst debtors, including Daiei, Japan's third-biggest retailer and UFJ's biggest bad debtor. The parties have now turned against each other. And that marks a welcome, and potentially decisive, change in Japan's traditional way of doing things.

Although Japan's economy is enjoying an impressive cyclical rebound, such a change is sorely needed. Since the bubble burst in 1989, Japan's previous upturns have followed a familiar and frustrating pattern. While exports and overseas manufacturing earnings, led by strong global firms such as Toyota and Canon, gave a temporary fillip to growth, much of the service sector remained bogged down by debt, depressed confidence and widespread inefficiency.

That could still happen again. Overall growth has already begun to slow, and may be more subdued next year. And even if exports continue to stimulate manufacturing growth, manufacturers—which now account for less than half of Japan's output—can no longer carry an inefficient ¥500 trillion ($4.5 trillion) annual economy on their back. If Japan's service firms are to contribute to a lasting recovery, they must boost their efficiency, improve convenience for Japanese consumers and seek out higher profit margins.

It is hard to think of a single non-manufacturing sector in which Japan excels. High domestic transport costs hinder distribution, travel and tourism. A lack of competition in energy and telecoms keeps business costs high. Professional services, such as law and accountancy, remain hidebound. Health care,

a crucial sector for a country that is ageing rapidly, has shamefully low levels of productivity by international standards. Consumers of many basic services, from finance to fitness, routinely encounter inefficiency and inconvenience. Above all, says Richard Jerram of Macquarie Securities, Japan conspicuously lacks “that American feeling that if you don't want to do it yourself, you can pay somebody to do it for you.”

The most abysmal service sectors over the past decade have been those at the core of the banks' bad-debt woes: construction, property and distribution. To some extent, this is natural. Sectors that get hit hard by an economic shock will end up littered with firms that cannot repay debts. In Japan, however, the problem has gone far beyond that. During financial crises elsewhere bankers typically stop lending to unviable borrowers. Japan allowed the zombies to emerge.

Daiei of reckoning

The archetypal zombie is Daiei. Throughout the miserable 1990s the company simply avoided its problems. Its inefficient retail operations range from supermarkets to clothing and household goods, and many of its giant stores lease space to dozens of its smaller, unprofitable subsidiaries. Daiei conspicuously lacks focus: it keeps chains of restaurants and hotels in its stable, along with a baseball team.

In the past three years, Daiei has been bailed out twice, in total receiving ¥640 billion ($4.9 billion) of assistance. Yet both times its lenders seemed more interested in relabelling Daiei as a healthy borrower than in pressuring it to fix its problems. They allowed it to leave its ill-fitting array of businesses intact. Daiei is now carrying over ¥1 trillion of debt, ¥400 billion of which it owes to UFJ.

Compare Daiei's behaviour with that of Aeon, Japan's biggest retailer. Motoya Okada, Aeon's president, says that his company and its rivals can no longer hide behind the regulations and maddening business practices that used to frustrate big foreign rivals. Since zoning restrictions were relaxed in the 1990s, a few global retailers, such as America's Wal-Mart, Britain's Tesco and France's Carrefour, have taken their first tentative steps in the Japanese market. Mr Okada's biggest challenge over the next few years, he says, will be managing the tension “between how much time we will need to become competitive, and how much time global retailers will need to understand Japanese consumers and the market.”

A few years ago, therefore, Aeon began to cut off inefficient wholesalers and streamline its logistical system. In some cases, it has done this by taking shipments directly from manufacturers, just as Wal-Mart does. Aeon started with a handful of suppliers: unsurprisingly, two of the first to co-operate were Japanese subsidiaries of western consumer-goods companies, Procter & Gamble of America and Unilever of the Netherlands. Three years later, Aeon now has similar arrangements with over 40 companies. Although Aeon continues to use wholesalers rather than direct delivery for many of its products, it is trying to boost its wholesale suppliers' efficiency by working with fewer of them on a bigger scale.

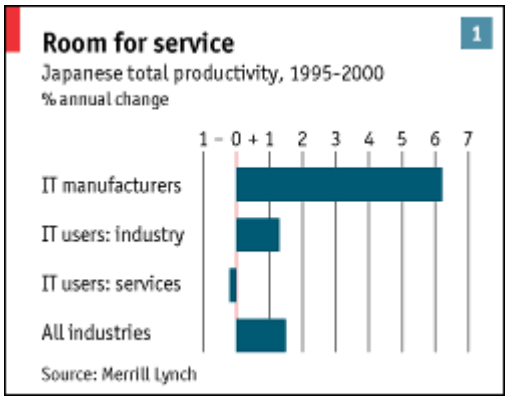
Aeon's next-biggest rival, Ito-Yokado, is also in a hurry to raise its game. It is copying the global giants by learning more about consumers' buying patterns, designing new foods that grab their tastes and delivering them to its supermarkets and convenience stores when and where they are needed. If Japanese retailing is to have any hope of becoming a healthy and profitable sector, firms like Aeon and Ito-Yokado will have to build on these initial efforts and drive their suppliers and competitors to adapt along with them or exit the business. It is hard for that to happen, however, when companies such as Daiei continue to exist only thanks to over-generous banks.

In retailing, property, construction and other zombie-laden sectors, it is the losers that have held the upper hand, forcing the winners to follow their lead. Recent research by Alan Ahearne of America's Federal Reserve and Naoki Shinada of the Development Bank of Japan found that productivity growth in the 1990s was exceptionally low in sectors that had lots of firms with non-performing loans. Even more damagingly, resources consistently flowed in the wrong direction within those sectors, with the least efficient firms gaining market share at the expense of healthier ones.

Research by Anil Kashyap of the University of Chicago's business school and others suggests that misdirected investment is the main culprit. In one poor-performing sector after another, the firms with the most bad loans increased their investments at the expense of healthier competitors. The zombies' twisted relationship with Japan's broken banks is clearly at the centre of this problem. Mr Kashyap shrewdly likens competing with zombies to trying to make money in a sector dominated by state-run firms. The zombies have been propped up by banks that were in turn given unjustified leeway by

accommodating regulators. The bill will one day land on taxpayers' doorsteps.

Such distorted competition has hurt Japan's service sectors in countless ways. Perhaps most important, the tendency to prop up weak firms has held back investments in information technology, one of the best ways in which service firms can boost productivity (see chart 1). Some of the most successful retailers in Japan over the past few years have been convenience-store operators such as Seven-Eleven Japan (owned by Ito-Yokado) and Lawsons, which make far better use of IT than the country's supermarkets and department stores. Last year Wal-Mart took a stake in Seiyu, another troubled retailer, since when it has invested heavily in IT. Around 130 of Seiyu's 400 stores now have advanced inventory and point-of-sale tracking systems. Employees no longer have to run to the back room to print out lists of goods that are in stock.



Back from the dead?

Dealing with Daiei and the other zombies is crucial to reviving retailing and other long-depressed sectors. But there have been encouraging signs. Japan's financial regulators have begun to force the biggest banks to assess their loan books more honestly and tackle more of their bad loans. Three of Japan's four remaining megabanks—Mizuho, MTFG and SMFG—issued sizeable chunks of equity in early 2003 and have used their stronger capital bases to make far greater strides than UFJ in cleaning up their bad loans. A profit-driven economic recovery has also allowed many marginal borrowers to regain solvency. Moody's Investors Service, an international rating agency, has upgraded the credit ratings of 38 Japanese firms so far this year, while downgrading only three.

In the equity markets, too, there has been a gradual improvement. As their cross-shareholding ties have wound down, Japanese companies are under more pressure from independent shareholders to boost returns. This has led many of them to jettison business partners that are not helping their bottom line. David Marra, a consultant at A.T. Kearney in Tokyo, reckons that competitive forces are even stirring up the sleepy world of distribution. He points out that five of the world's ten-biggest retailing mergers last year took place in Japan.

In a range of other service sectors, too, more competition, faster asset restructuring and slightly more openness to foreign direct investment are driving the adoption of commonsense business practices. In telecoms, Softbank, an information-technology firm that includes a broadband internet service and the Yahoo! Japan web portal, has declared a price war against NTT, the former telecoms monopoly. In May, Masayoshi Son, Softbank's founder, bought the fixed-line assets of Japan Telecom from Ripplewood, an American private-equity fund that had acquired the assets last year in a ¥260 billion leveraged buy-out, Japan's biggest ever. Last month Mr Son announced that he would begin offering new discounted fixed-line rates, in a direct attack on the former monopoly's highly priced service.

Japan's powerful regional utilities continue to thwart the emergence of true market forces in its energy sector. Next month, however, the government will privatise J-Power, the country's biggest electricity wholesaler. Next April Japan will launch a financial exchange for trading electricity, which should encourage new entrants, weaken regional monopolies and increase competition.

Even in financial services, the banks are waking up to the need to seek out better business lines and boost profits. The big banks have been teaming up with consumer-finance outfits, for example, which offer better prospects than their moribund corporate-lending businesses. Still, Japan's banks remain woefully unprofitable. It is no coincidence that two of the most successful lately have been Shinsei Bank and Aozora Bank, both bought and turned around by foreign private-equity firms.

Aiming to serve

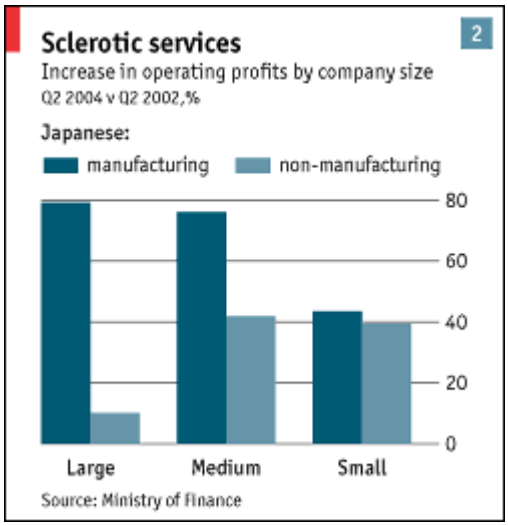
In other areas, Japanese officials have been slowly lowering some of the barriers that stifle competition, such as limits to foreign direct investment. If Japan is to make these gains stick, however, its government will need to press ahead on several fronts.

One is the postal system. Japan Post not only subsidises mail delivery, but its postal-savings and life-insurance accounts interfere badly with the allocation of Japan's massive pool of savings. Junichiro Koizumi, Japan's prime minister, wants to privatise the whole system, but that will not begin until April 2007 and the process is slated to drag out over a decade. It is far from clear whether and when Japan Post will face true competition.

The government must also accelerate its efforts to liberalise and clean up Japan's regional economies, most of which are far weaker than the area around Tokyo. One of the most important reforms championed by Mr Koizumi, has been an effort to increase regional experimentation. He has allowed local governments to create special zones, and then petition for exemption from regulations on a case-by-case basis.

At the south-western port of Kita-Kyushu, for example, the government has permitted Nippon Steel to build its own power-transmission lines, connecting its power-generation plant to other factories in the area. Next February, Nippon Steel will begin bypassing the local utility and selling excess electricity to its neighbours. This approach could eventually become a powerful impetus for change. Japan's prefectural governors, along with mayors in a handful of big cities, have been gaining political clout. They have begun to challenge the central bureaucracy, and several successful experiments have led other parts of the country to demand more deregulation.

None of these changes will matter, however, if Japan's decision-makers do not press ahead with cleaning up the banks. They still face a huge challenge among regional banks, many of which remain fused to their zombie borrowers. Here, the government has barely begun to employ the same combination of tough bank regulation and recapitalisation that has worked so well at the big banks. Regional banks tend to have bad loans from a range of small companies on their books. Although profits at small companies have begun to rise (see chart 2), buoyed by the latest recovery, the process of gradually weeding out the weakest firms and forcing them to merge or shut down altogether could be lengthy.



Banking on change

The big litmus test, however, will be the way the government handles UFJ. It is pressing the bank to reduce its bad-loan ratio to 4% of the total by the end of March next year, from around 10% now. This will be impossible without sorting out big loans to some of Japan's most notorious zombies. Besides Daiei, property developers such as Misawa Homes and Daikyo, and Sojitz, a troubled trading company, have been scrambling to put together rescue plans. Another troubled UFJ borrower, Kokusai Motorcars, has agreed to sell some of its property to a private-equity firm.

Even with the ¥700 billion capital injection that it plans to receive from MTFG, however, UFJ will only be able to write off a portion of the bad loans that it needs to shed. It will have to tackle the remainder, and it is not yet clear whether this will be done through genuine restructuring or whether UFJ and its new partner are counting on regulators to tread softly.

The progress to date has been rapid by Japan's standards. And Japan's decision-makers have plenty going in their favour. It has been a long time since the megabanks, UFJ aside, looked better. And high profits and capital spending have been helping even many troubled small borrowers improve their finances.

Given Japan's ageing and wealthy population, the provision of better services could be a huge growth industry. Japan could conceivably at last contemplate the kind of virtuous cycle that would help it achieve long-run growth. As its service sectors expand and adopt better practices, they can begin delivering the sorts of convenient services that allow people to live—and work—more flexibly. Some of those people, including many retirees and homemakers, might then be freed up to join the labour force or work more hours, giving a further boost to the service sector. What holds for labour is equally true for capital, which can be redirected from inefficient domestic sectors and to creative entrepreneurs who figure out how to offer a better deal to consumers.

In the end, those sorts of mutually reinforcing ties will prove to be far healthier and sustainable than the

dysfunctional relations that have bound banks and zombies together. The bust-up at UFJ and Daiei? It is an early skirmish in the battle for Japan's economic future.

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Oil revenues

The $300 billion bonanza

Sep 23rd 2004
From The Economist print edition

What might oil producers do with all that extra cash?

IT SHOULD be easy to work out what people with $300 billion to spend are doing with their money. According to America's Department of Energy, that is the sum that members of the Organisation of Petroleum Exporting Countries (OPEC) will haul in this year. Thanks to the surge in the price of oil, to nearly $50 a barrel a few weeks ago, the cartel's export earnings are running at almost three times what they were in 1998, when a barrel fetched only around $10.

In fact, getting to the bottom of the bonanza is no simple task. For a start, the amount of oil exported is not known with great precision, thanks to OPEC's secretiveness about production capacity. That makes it impossible to put a precise figure on OPEC's revenues. Sharif Ghalib of the Energy Intelligence Group, an industry publisher, uses different assumptions from the Department of Energy and comes up with a figure of $360 billion.

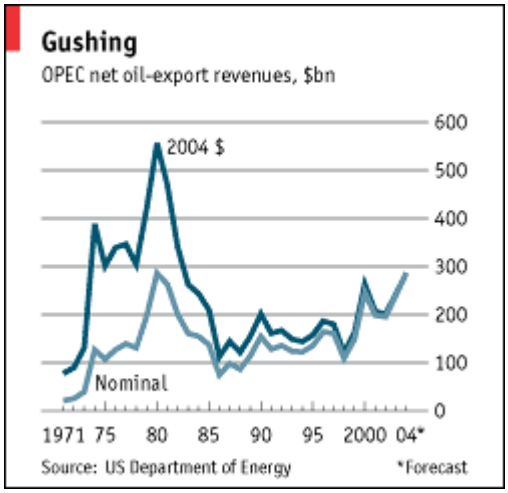
As for what is being done with the money, it is hard to unravel patterns of domestic spending inside OPEC, given that the accounts of most oil producers are not worth the paper they are printed on. Finally, it is tricky to work out the impact of “petrodollars” on the global financial system—especially when economic growth is decent, credit is easy and sources of liquidity are hard to identify.

History suggests that petrodollars can cause trouble, both for oil producers and for others. During the last great oil-price boom, in the 1970s, OPEC countries spent a lot, on lavish infrastructure projects at home, and saved a lot, in western commercial banks. The former wrought predictable distortions on their domestic economies. The latter had ill effects too, after the western banks lent freely to developing countries. This looked fine at the time—after all, the world's poorest countries needed capital. Alas, too much was lent and borrowed. Bankers were left embarrassed. Many of the world's poor suffered far worse, as their economies were saddled with enormous debts.

This time around, there may be less need to worry. One reason is that the windfall is smaller. Although revenues of $300 billion would be close to OPEC's largest ever in nominal terms, they would be far below the peak once inflation is taken into account (see chart).

Even so, oil producers have a fair bit in their coffers. The Institute of International Finance (IIF), a think-tank run by the financial industry, estimates that the six oil economies of the Persian Gulf

will spend perhaps $200 billion on infrastructure projects during the next three years. Even so, reckons the IIF, they will enjoy a combined fiscal surplus this year and next of about 10% of GDP. Plenty will be invested abroad: the six should chalk up a current-account surplus of some $70 billion this year and next, about 15% of GDP.



Some are worried that easy money will spawn old mistakes, in the shape of popular but unsustainable spending schemes at home. That would be unfortunate, given that the shock of $10 oil has only recently led many oil-producing countries to embrace subsidy reform, trade liberalisation and saner fiscal policies. In the case of the big producers in the Persian Gulf, that worry looks premature. So far, it seems that these countries, especially Saudi Arabia, are using their windfalls to reduce their debts and balance their budgets. Moreover, says Fareed Mohamedi of PFC Energy, a consultancy, the population boom of the past few decades means that the capacity of these economies to absorb extra public spending is far greater today than it was three decades ago.

There is more cause for concern about Venezuela and Russia. Venezuela's president, Hugo Chávez, has used his windfall to expand social spending in politically clever, if economically incautious, ways. In Russia, which now vies with Saudi Arabia to be the world's biggest oil producer, there are signs that President Vladimir Putin, who has recently consolidated the state's grip on various parts of the energy sector, may loosen the budgetary belt.

The Russian authorities have attempted to squirrel away some of their petrodollars, and avert upward pressure on the rouble, by setting up a stabilisation fund to capture extra revenues. Unfortunately, the kitty is open to raids by politicians. Although Alexei Kudrin, the finance minister, promised the money would be used to repay debt and plug pension holes, some analysts worry that the prime minister, Mikhail Fradkov, who is set on fulfilling Mr Putin's goal of doubling GDP by 2010, has other ideas. Recently, Anne Krueger, a top official at the International Monetary Fund, publicly warned the Russians “against further fiscal relaxation, however good the current numbers look.”

The impact of the extra oil revenues on international financial markets is hard to assess. Flows of funds are never easy to trace, especially when their sources are keen to keep them quiet. There are dark whispers in oil circles that cartel members, especially Saudi Arabia, want to keep much of their new money out of American banks and markets because of “post September 11th scrutiny.”

Official statistics on the ownership of American Treasury bills, for example, show that OPEC countries' holdings are around $44 billion, $8 billion less than two years ago. Rebecca McCaughrin of Morgan Stanley, who has analysed the recent windfall, believes that the cartel is even shunning American goods. So far this year, oil producers' imports from the euro zone are up by a quarter on 2003: imports from America are up by just 8%.

Meanwhile, tens of billions of dollars are certainly finding their way into the offshore funds set up by some oil producers. Norway's pot, for example, contains perhaps $140 billion, and may receive another $13 billion this year. Other countries, including Mexico, Azerbaijan, Kazakhstan and East Timor, have set up similar funds, and are pouring money into them. Now Russia is joining the club.

Some are sceptical about the value of this—one recent article on the topic in the IMF's own quarterly was entitled “Oil Funds: Problems posing as solutions?”. However, argues Svetlana Tsalik of the Open Society, a group financed by George Soros, a well-known investor and philanthropist, these funds can help to sterilise capital inflows and (in theory) to save for a rainy day. The key, she insists, is that countries should get their policy and institutional frameworks right.

Whether or not these funds are good for producing countries, their investments in foreign markets appear to be no cause for concern just now. Ms McCaughrin estimates that “the [OPEC] cartel probably accounts for no more than 5% of global cross-border capital flows.”

This tallies with the IIF's estimates that the six big Gulf economies have increased their foreign assets by an average of $30 billion per year over the past five years, and might do so by about $80 billion this year and next. That may sound like a lot, but given that the world economy is far larger than it was during OPEC's last bonanza, Ms McCaughrin concludes that it is “still much too small to have more than a

marginal impact.” For the moment at least, the world seems safe from the menace of another petrodollar crisis.

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American interest rates

Up a notch

Sep 23rd 2004 | WASHINGTON, DC
From The Economist print edition

As expected, the Fed raises rates again

AP

Musing about the next move?

ANOTHER Fed meeting, another rate rise. To no one's surprise, America's central bank lifted short-term interest rates by a quarter point on September 21st, to 1.75%. The Federal Reserve's policy-setting committee has pushed up rates by 25 basis points at each of its three last meetings, as part of a strategy, widely signalled to financial markets, of raising interest rates from their rock-bottom levels at a “measured” pace. There is uncertainty on Wall Street, however, about how high rates will eventually rise and, more immediately, about whether the Fed intends to take a breather soon.

After America's economy slowed over the summer, speculation on financial markets grew that the central bank might at some point pause from hiking rates. Markets remain unconvinced of the economy's strength: on September 22nd, the yield on ten-year Treasuries fell below 4% for the first time since April, and futures markets are pricing in extended pauses in rate increases from December.

The Fed, though, remains upbeat. Its statement this week pointed out that “output growth appears to have regained some traction” and suggested that labour markets had “improved modestly”. And it repeated a phrase, much used of late, about raising interest rates “at a pace that is likely to be measured”. No hints, in other words, of any imminent pause.

Indeed, Alan Greenspan, the Fed chairman, has sounded sunny all along. In July, he made clear that the slowdown was, in his view, a temporary “soft patch” caused largely by higher energy prices. On September 8th, Mr Greenspan told Congress that the expansion had “regained some traction”. It is no coincidence, of course, that the Fed's statement this week used almost identical language.

There is some evidence that the economy is picking up. Although far from stellar, the pace of job growth in August, at 144,000, was much quicker than in June or July. Unemployment claims remain near recent lows. Manufacturing output rose at an 8.6% annual rate in July and August. Against that, there are weaknesses: retail sales, for instance, fell by 0.3% in August, thanks to a drop in car sales. The build-up of inventories, which in August reached their highest, relative to sales, for five months, is worrying. But most economists believe that the economy will grow at a pace of 3.5-4% in the third quarter, compared with only 2.8% in the second. And this week the Organisation for Economic Co-operation and Development said that it expected American growth to regain in the second half of the year some of the vim it lost in the first.

This is enough, in other words, for the Fed to carry on its “measured” march towards higher rates, even though inflationary worries have ebbed since the spring. Monetary policy remains extremely loose. By many measures, real short-term interest rates are still negative: overall consumer prices rose by 2.7% in the year to August. There is little justification for a pause yet. Still less is there any sign of one.

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Credit derivatives

Russian doll

Sep 23rd 2004 | FRANKFURT
From The Economist print edition

A lawsuit may shed light on some complex deals

CONSIDERING its giant size, the decade-old credit-derivatives market is remarkably free of public squabbles. According to Fitch, a credit-rating agency, $3 trillion of contracts were outstanding at the end of last year. Yet any dispute is usually settled between professional dealers and losses are taken on the chin. This may help the market run smoothly, but it does not make it transparent. So a battle in public would be of great interest to outsiders who would like to understand the market better. Such a fight is looming.

Stone the crows
Rating of tranches of the Corvus portfolio

Tranche	Amount $m	Dec 2000	Dec 2002	Sep 2003
A1	*550*	AAA	A+	BB
A2	*200*	AAA	A+	BB
B	*65*	AA	BBB	BB
C	*60*	A	CCC+	CCC
D	*40*	BBB	CC	CC
E	*25*	BB	C	C
F	*10*	B	C	C

Source: Fitch

Credit derivatives are contracts under which one party insures another against the default of a debtor, or a bunch of debtors. Of the $3 trillion, about $800m are complex beasts known as collateralised debt obligations (CDOs). These are portfolios of credit risk, constructed from bonds or loans, or synthetic portfolios created from credit derivatives. The CDOs are sliced into “tranches” of different riskiness and sold to investors: the riskier the tranche, the higher the expected return. These deals are monitored by rating agencies, which rate each tranche according to its perceived likelihood of default, from AAA (the best) to C (the worst).

Some CDOs, known as “Russian dolls”, contain investments in other CDOs, making their monitoring extremely complicated. To make matters more difficult still, some CDOs are actively managed—ie, the composition of the underlying portfolio can be changed by the asset manager.

In December 2000 Barclays, a big British bank, launched a Russian-doll CDO called Corvus (the Latin for “crow”), with a face value of $950m in tranches rated from AAA to B. Corvus performed badly, particularly after September 11th 2001. Fitch began to downgrade it in December 2002, and in early 2003 took the unprecedented step of publishing details of the Corvus portfolio on its website. It included some unexpected stuff—for instance, exposure to airline leases and loans for prefabricated-housing in America. It also had exposure to other CDOs, all constructed by Barclays, some of which were never sold externally. By September 2003 the top three tranches of the CDO had fallen below a BBB rating (to “junk” status). The other four tranches were rated CCC or lower. A similar Barclays CDO, called Nerva, fared even worse.

Investors were not amused: AAA ratings are not meant to deteriorate so rapidly. One big customer, the European Bank for Reconstruction and Development, is believed to have settled with Barclays. After fruitless discussions with Barclays, another client, Landesbank Schleswig-Holstein, a publicly owned German bank now part of HSH Nordbank, has filed a suit in London against the British bank, related to its $151m investment in Corvus. Hamburgische Landesbank, now also part of HSH Nordbank, is also considering a suit related to its $420m investment in Corvus and Nerva.

HSH Nordbank argues that Corvus was misleadingly constructed in the first place, and that it was subsequently badly managed. Barclays insists that its managers did not fail to comply with the portfolio guidelines. The case is due to be heard in February unless the parties can settle.

If the case does come to court, others will get to see how these complex financial instruments are put together and managed. One question for the court is whether Barclays correctly managed the potential conflict of interest when selecting credit risks from its own exposures for the CDO portfolio. Investors were not given details of each credit; Barclays argues that such disclosure was not required by the terms

of the CDO. “The allegations in the suit are without merit,” says a spokesman for the bank.

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Deutsche Bank

Weak or strong?

Sep 23rd 2004 | FRANKFURT
From The Economist print edition

A veteran ducks out

WILL the abrupt departure of Ulrich Cartellieri, long a strong man on Deutsche Bank's supervisory board, weaken or strengthen Josef Ackermann, the bank's beleaguered chief executive? That was the question buzzing round Frankfurt banking circles on September 22nd, when it was reported that Mr Cartellieri would leave. Only the day before, Germany's biggest bank had announced a shake-up in its management structure.

Investment banking is to be streamlined under two co-heads; and Jürgen Fitschen, a German, will be in charge of a new management committee for Germany. The latter change is apparently intended to answer criticism that the bank had neglected its German roots while trying to build a global presence. It seems that Mr Cartellieri was not convinced. It is unprecedented for a member of Deutsche's supervisory board to quit so suddenly. He served on the management board from 1981 to 1997 and is revered within the bank.

The monthly that broke the story of Mr Cartellieri's departure, *Manager Magazin*, claims that others on the supervisory board share his reservations about Mr Ackermann's running of the bank. Several German newspapers, which have taken to hounding Mr Ackermann, have argued this week that he has lost the credibility to see through the acquisition of another big German bank, which they believe is now needed to bolster Deutsche's customer and capital base. On the other hand, a number of investment bankers believe that without Mr Cartellieri around Mr Ackermann will be freer to pursue the goal he has set the bank.

That, above all, is to increase its pre-tax return on equity to 25% by the end of next year. Mr Ackermann's strategy has been to rely heavily on investment banking and trading profits, while shrinking the bank's low-margin lending and attempting to expand the retail and private client base. But he has had trouble achieving the right balance.

Will the new structure help? Hmm. Mr Fitschen, billed as the new German supremo, has no power over the profit-and-loss account of any part of the bank. “No P&L means no control,” snorted a rival investment banker. The new heads of corporate and investment banking, Anshu Jain and Michael Cohrs, do have such control and appear to have strengthened their hand. That might make it more difficult for Mr Ackermann to take any step—such as an acquisition of another German bank—which could temporarily affect Deutsche's dealings in the capital markets, where their part of the bank makes its money.

Mr Ackermann may have streamlined the structure, but his ability to steer a new course is still in question. At least there is no obvious challenger for his job.

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Citibank in Japan

Sayonara

Sep 23rd 2004 | TOKYO
From The Economist print edition

A bad week in Japan for the giant American bank

EPA

The light shines less brightly

HOWEVER you view it, it looks painful. On September 17th, Japan's regulators ordered Citigroup to close its private-banking offices in Japan. The world's biggest bank by stockmarket capitalisation will soon be shut out of the world's second-biggest market for wealthy clients, where it has maybe 10,000 such customers and once had high hopes for boosting profits.

In issuing its sanctions against Citibank Japan, the country's Financial Services Agency (FSA) cited improper transactions and a flawed system of controls that allowed abuses to take place. It accused the private bank of selling securities and derivatives at “unfair” prices to their clients, many of whom appear to have been rich but unworldly, without explaining the risks. It also claimed that Citibank ignored warnings to teach its salesmen better practices and to keep a closer eye on them. On top of that, the FSA took Citibank to task for letting a client open an account that “could be suspected of being associated with money laundering” while giving too little thought to what it was doing, and for lending money to clients who used the proceeds to manipulate share markets.

The bank, the FSA went on, had constructed “a law-evading sales system that disregards the laws and regulations of Japan”, and had done so “in a management environment in which profits are given undue importance by the bank headquarters”. This followed continued failure to improve internal controls, despite regulatory warnings going back three years and a scolding by the FSA in May.

Douglas Peterson, who took over Citigroup's Japanese arm in May, will now have to overhaul the bank's local practices and rebuild its reputation. Citigroup has not tried to play the charges down, and issued a memo to employees highlighting “the serious consequences of failing to comply with regulatory requirements and violating our business standards.”

Nonetheless, Citigroup will continue to make money in Japan. The private-banking business can no longer take new clients, and must wind down existing accounts within a year. But Citigroup still runs a retail bank, which has been serving Japanese customers for a century and enjoys a reputation for convenient service and for financial soundness. It also has a corporate bank, which provides cash management, currency trading and other transactions for business clients. There is also a securities joint-venture with Nikko Cordial. All three businesses may worry that Japanese clients will shy away now that Citigroup's reputation in the country has been tarnished.

The punishment in Japan has not been Citigroup's only bit of bad news outside America lately. It was recently embroiled in a ruckus over a controversial European bond-trade. Still, the immediate damage of the decision by Japan's regulators to the group's bottom line is small. Worldwide, private banking accounts for about 3% of Citigroup's profits. The Japanese unit chips in perhaps one-sixth of this.

But might the Japanese episode lead to trouble elsewhere? Guy Moszkowski, a bank analyst at Merrill Lynch, thinks so. In a report this week, he warned that Citigroup could have difficulty in growing private-banking markets in other Asian countries, such as China and India. He also suggested that it might attract scrutiny from regulators outside Japan—noting the FSA's remarks about pressure from head office in New York. Of course, Mr Moszkowski's worries may prove to be overblown. Whether they do or not,

this has been a bad week for Citigroup.

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Mutual funds

Low Fidelity

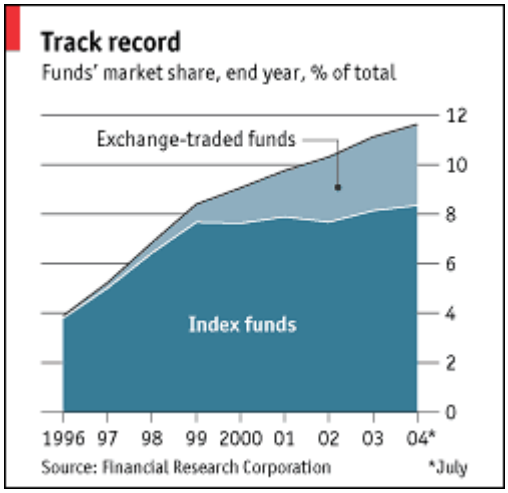
Sep 23rd 2004 | NEW YORK
From The Economist print edition

A big fund manager's cut to its fees may unleash long-overdue price competition

PITY, if you can, America's retail asset-management industry. Soon, much of it may lose the ability to command fat fees for providing little value. Why this has not happened before is a mystery. For many years, there has been a steady flow of academic studies concluding that the one important, controllable variable for achieving good investment results is cost. Retail investors, however, have seen precious little competition on prices. Even for wretched performance, reductions in fees have been all too rare. Increases, for instance to cover rising marketing costs, have been all too common. Even managers of index funds—which seek to do nothing more exacting than track the stockmarket as a whole—have enjoyed juicy margins.

There have been only two important exceptions to this rule: Vanguard, a fund-management firm devoted to low fees; and exchange-traded funds (ETFs), a relatively new breed that is, in essence, an index fund built into a stock. But, successful as these two have been, their collective market share has been restrained by quirks of their distribution. Vanguard is a cautious marketer, as eager to avoid costly clients as to capture new ones. The low cost of ETFs is a consequence of their low marketing fees; but that also means there is no salesforce eager to push the funds.

All told, index funds comprise less than 9% of the retail market, according to Financial Research Corporation, a Boston consulting firm (see chart). The number could soon jump because Fidelity, America's largest fund-management company, is cutting the fees on its five main equity index funds to a tenth of a cent per dollar invested. That is within range of what large institutional investors pay. It is little more than half the price of comparable offerings from Vanguard or of any ETF, and less than one-twelfth of the fee levied by the average mutual fund.



Unlike Vanguard or an ETF provider, Fidelity is not shy about marketing and will therefore ensure that its new, low prices cannot be ignored. Merely notifying its existing customers alerts 21m people. Large advertisements have been taken out in leading newspapers.

The first to feel the impact will be Fidelity itself. Financial Research Corporation puts the cost of the fee cuts at $34m. However, Fidelity, a family-controlled firm, can be patient in seeing an investment through. It expects that the price cuts will be offset before long as word gets out and money rolls in. Its greatest risk is that a lot of the money could come from its own actively managed funds. The fees on these are much lower than on the average active fund but are still far above the new rate on Fidelity's index trackers.

As far as Fidelity's competitors go, the most vulnerable in the short term are, curiously, the ones that do the best job on fees now: Vanguard and ETFs. This is because their customers are the most sensitive to charges. The chances are that money already invested with Vanguard or in ETFs will stay, because moving it would trigger capital-gains taxes, but future investments could fall prey to Fidelity.

That said, Vanguard is well equipped for a fight. It offers good service; it has loyal clients; and it has been swift to point out some of the fine print in Fidelity's offer. The reduction in fees takes the form of a “waiver”, not an outright cut, and therefore could be quickly reversed. Years ago, indeed, Fidelity reversed a reduction in the price of its money-market funds. It is hard to imagine, however, that

customers of ETFs will be as loyal as Vanguard's or will care too much about the details. If a cheaper alternative exists, it is a fair bet that they will jump at it.

Fidelity's real battle, though, will not be with Vanguard or the ETFs but with the rest of the fund-management industry. Over long periods, fees take a huge bite out of returns. The recent flat performance of equity markets has made the effects of high charges more visible. With returns low, investors are more likely to notice a cheaper alternative.

Moreover, by driving down fees so far, Fidelity has given its retail index funds an edge not only against other retail funds, but also, perhaps, against various tax-advantaged investments. These include many corporate pension-plans and some state programmes set up for college savings that are grossly inefficient. At the very least, the inadequacy of these programmes will be put into stark relief. Nothing that even regulators could do would be better for investors than a simple price cut like Fidelity's. Let battle commence.

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Argentina's default

Shooting the messenger

Sep 23rd 2004 | SÃO PAULO
From The Economist print edition

The continuing saga of Argentina and its creditors

Get article background

"WHEN you're trying to close a $100 billion deal, do you want to fire the one man with a strong following on Wall Street?" wonders a pained observer of Argentina. The deal is a mooted restructuring of debt which Argentina stopped servicing in 2001, the largest sovereign default ever. The ousted icon is Alfonso Prat-Gay, who was not reappointed last week as president of the central bank—in part, it seems, because he objected to the government's needlessly rough treatment of bondholders.

Bad haircuts

Selected sovereign-debt restructurings

Country	Value, $bn	Default	Value at default*, %	Restructuring	Restructured value†, %
Russia	20.2	Dec 1998	6	Aug 2000	35
	1.3	May 1999	35	Feb 2000	43
	6.4	Jun 1999	12	Aug 2000	36
Ecuador	0.4	Oct 1999	30	Aug 2000	53
	0.1	Oct 1999	38	Aug 2000	62
	2.9	Oct 1999	22	Aug 2000	33
Côte d'Ivoire	0.8	Oct 2000	15	–	–
	0.4	Oct 2000	15	–	–
Pakistan	0.3	–	–	Dec 1999	65
Ukraine	0.7	–	–	Feb 2000	61

Sources: CSFB; Bloomberg; Thomson Datastream; Reuters

*Market value as % of face value at time of default
†Market value of new bonds as % of original face value

Argentina proposes that creditors, who range far beyond Wall Street, accept new bonds worth 75-80% less than the originals, a much bigger "haircut" than in other recent restructurings (see table). Worse, it plans to impose a deal on bondholders, not to negotiate one; those who spurn it can try their luck in the courts. If Argentina gets away with this, warns Hans Humes of GCAB, which claims to represent holders of nearly half the defaulted bonds, other developing countries will be tempted to renege, jeopardising the entire market for such debt. There is, however, reason to hope Argentina may yet soften its tactics.

After Argentina's recent traumas, its stance is unsurprising. Nearly half the population is below the poverty line and the government, understandably, would rather spend money on investment and social programmes than on debt. It has thus resisted pressure from private creditors and the International Monetary Fund to raise the central government's primary surplus (ie, before interest payments).

The president, Néstor Kirchner, scores easy political points by snubbing international bankers. In New York this week, for example, he is not expected to meet anyone from GCAB. The IMF and America's Treasury, which normally take the lead in cajoling borrowers to deal with creditors, have taken "a laissez-faire approach", charges Nouriel Roubini of New York University's Stern School of Business. Nearly three years have elapsed since the default, "setting a precedent," says one specialist, for "how not to" run a debt restructuring.

Argentina's stubbornness has paid off so far: its economy is rebounding, there is plenty of cash to finance investment and the government is saving some $700m a month by not paying its creditors. But the costs of pugnacity will soon mount. The central bank has given warning that unless Argentina regains access to

international capital markets the cost of renewing domestic debt in 2005 and 2006 will drag down growth. And Argentina will need fresh money from the IMF to repay it next year. It may not get that without a deal acceptable to, say, 70% of bondholders.

Achieving that would not be expensive. Igor Arsenin of CSFB, an investment bank, says that a “couple of tricks,” such as slightly shortening the maturity on new bonds to be offered in exchange for defaulted debt, could raise the value of Argentina's offer to around 30 cents on the dollar. Such tweaks could “lead to a much higher participation level in the deal.” The draft budget for 2005, presented last week, aims at a surplus of 3.6% of GDP, though some think this could rise to 3.9%. Not quite enough, says the IMF.

If all goes well, Argentina will end up with a much lighter debt burden and the grudging consent of its creditors. Might other borrowers be tempted to follow its example? There is little sign of it. Brazil, one of the biggest debtors, rejected default and its economy is expected to grow by 4% this year. Uruguay arranged a debt swap in 2003 and was tapping capital markets again within the year. “After Argentina [risk] spreads are very low and countries are borrowing like crazy,” notes Mr Roubini. Creditors now hope that Argentina will soon tire of its tango for one.

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Economics focus

Oversold

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The World Bank changes its tune on Latin America's privatised pensions

AS THEIR populations age, many countries are grappling with the problem of how to reshape their onerous, tax-financed pension schemes. Latin America, however, has been a laboratory for pension reform. Starting with Chile in 1981, several countries, including Peru, Argentina and Mexico, have got on with the job. The details have varied across the region but, overall, pension provision has shifted decisively to a privatised model. What can the rest of the world learn from Latin America?

A new study* by the World Bank presents the first full analysis of the Latin American experiment. The book is particularly significant because the Bank has pressed for a much bigger role for privatised pensions since publishing a landmark report, “Averting the Old Age Crisis”, ten years ago. The Bank set out then a model of pension reform based on three “pillars”: first, a tax-financed public safety-net; second, compulsory saving by workers, generally into individual pension accounts; and third, voluntary saving for retirement.

The study says that the main success of Latin American pension reform has been to improve governments' finances. Expensive pay-as-you-go pension schemes—paying for pensions out of current taxes—have been scaled back. Future generations will no longer be saddled with oppressive pension commitments. In several countries, the Bank finds, reform has galvanised the development of capital markets and helped to modernise the financial system, both by improving the quality of regulation and by generating services such as risk-rating. Real returns in the new pension funds have generally been impressive. In Chile, pension privatisation seems to have imparted a modest boost to economic growth by improving both capital and labour markets.

Overall, the reformed pension systems are manifestly better than the ones they replaced. However, that was not difficult. Latin America's pay-as-you-go schemes had been grossly mismanaged. They had made over-generous promises, which could not be honoured in the longer term and were already ruinously burdensome. The schemes combined profligacy and inequity by directing benefits mainly to a small elite of better-off employees.

The question that matters now is whether pension privatisation is delivering the benefits for individuals that the reformers promised. Here the study's appraisal is bleaker. It is a great disappointment that so many workers remain outside the pension system altogether. In Chile, over half of the labour force is covered, but in most countries that have privatised the rate is typically about 20%. If coverage remains this low, the reforms may not prove politically durable since they are not creating a comprehensive system of income security in old age.

Why are so few covered? Despite the pension funds' high returns, workers have good reasons to avoid the new arrangements. Excessive charges have been a persistent complaint since the earliest days of reform. They bear down particularly on the first cohorts of workers in the privatised schemes, who shoulder the start-up costs. And even privatised pensions have remained subject to political risk. In some countries, pension funds have been directed to invest heavily in government bonds, and severe restrictions have been put on investments in foreign securities. Workers in Argentina incurred big pension losses when the government defaulted on its debts.

However, the most important reason why workers have shunned the privatised pensions is probably that they require too much mandatory saving. Contribution rates have typically been set at 10% of salary. With high charges on top, this is a lot to ask poor and young workers to put aside, especially when they are bringing up children. In Chile, many workers try to avoid further mandatory saving once they have

contributed for at least 20 years—a condition for the right to receive a minimum pension guarantee from the government.

Pillars of society

The authors conclude that the multi-pillar pension model is out of kilter. More should be done to build up the first pillar, the public safety-net, to prevent poverty in old age. The second pillar, compulsory saving, is too prominent and should be scaled down. This would free resources to go into the third pillar, voluntary saving, which is currently stunted. This would in turn administer an overdue dose of competition to the cosseted, oligopolistic pension-fund industries that have emerged in Latin America. Eventually, mandatory saving into individual accounts should be phased out.

This bold prescription is of broader international relevance: it runs counter to the calls in Britain, for example, for compulsory saving to rebuild the country's battered pension system. But there is a snag with abolishing the mandatory pillar. Workers might not respond by saving more voluntarily. The authors insist that the first pillar is conceptually different from the second and third: the state safety-net provides an insurance against old-age poverty, whereas individual saving is a way of smoothing consumption over a lifetime. In practice, though, they are linked. If the safety net is made more generous then workers need to save less, in total, to maintain a minimum standard of living in old age. That might further increase the burden on the state.

Such difficulties illustrate that there are no simple solutions to pension reform. Yet for a while in the 1990s, the proponents of pension privatisation suggested that a single model could be applied to any country. The World Bank itself contributed to that notion, so this book is a salutary correction. The uncomfortable truth is that Latin America's pension reforms—like the pensions themselves—were oversold.

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* "Keeping the Promise of Social Security in Latin America", by Indermit Gill, Truman Packard and Juan Yermo. To be published in October by Stanford University Press.

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About sponsorship

Exoplanets

In search of the Earth mark II

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NASA

Earth-sized exoplanets should soon be discovered

PEOPLE assimilate change easily. Mobile phones, a rarity in 1990, are now taken for granted in much of the world. When Neil Armstrong landed on the moon 35 years ago, the Earth stopped to look and listen. Now, manned spaceflight is banal. And when the first “exoplanet”—a planet orbiting a star other than the Earth's own sun—was discovered in October 1995, it was a remarkable moment. It was the first tangible step towards answering one of the oldest questions around: does life exist elsewhere in the universe? But the extraordinary has rapidly become commonplace in this case, too. In the eight intervening years, 130 exoplanets have been found. Discovering yet another is no longer news—there must be something special about the discovery for it to register.

In the past few weeks there have, indeed, been some special discoveries. In August, a group called the Trans-Atlantic Exoplanet Survey (TrES) detected a planet indirectly using telescopes with puny 10cm-diameter mirrors and lenses—the sort of instrument that an amateur would employ. That suggests planet hunting might soon complete the journey from being at the cutting edge of astronomy to being a backyard pastime, like comet spotting. Then, in early September, two groups announced the discovery of the smallest exoplanets yet found—about the size of Neptune. Still more recently than that, a team from the European Southern Observatory (ESO) proclaimed that it had taken what it thought was the first actual photograph of an exoplanet—a dim spot of light next to the bright one of the putative planet's sun. The question is whether these events are leading to the milestone that everybody wants to reach next—the discovery of a small, rocky exoplanet that would herald the true beginning of the search for the Earth mark II.

Rest high above the clouds

For now, actually taking pictures of exoplanets remains difficult (and controversial; the ESO result is disputed by some of the observatory's rivals). Most known exoplanets have been found by one of three less-direct techniques.

The first of these is Doppler spectroscopy, which detects the wobble in a star's movement caused by the gravity of an orbiting planet. It does so by observing in light waves the same effect that causes the sound waves of an ambulance's siren to increase or diminish in pitch as the vehicle speeds towards or away from an accident.

The second technique is photometry, which sees the dimming caused when a planet passes in front of its

star. This is of limited use, because it detects only those exoplanets whose orbits take them between their star and Earth (though it is quite sensitive: it was the technique used by the TrES researchers). The third trick, astrometry, also relies on the gravitational wobble, but it detects this directly by precise measurement of a star's position.

Although Doppler spectroscopy has been the most useful technique until now, its days are probably numbered. Stars expand and contract naturally, and that means the technique's margin of error is too large for it to be used to find Earth-like planets. But the other two techniques will see increased application—not only on Earth, but in space.

COROT, a French satellite scheduled to be launched in 2006, is designed to discover planets photometrically. *Kepler*, a similar American mission, is scheduled for launch in October 2007. And another American satellite, the *Space Interferometry Mission* (*SIM*), which will use astrometry, is planned for 2009. The *SIM* will measure the positions of between 10,000 and 30,000 stars, and to do so a hundred times more precisely than they are now known. Among other things, that will reveal which of those stars have planets.

Any of these missions might strike lucky, and pick up a few Earth-sized planets as part of its haul. But to draw useful conclusions about anything in science, it helps to have lots of examples—and that is what two further projects, pencilled in for the next decade, should provide.

A null result

America's *Terrestrial Planet Finder* (*TPF*) and Europe's *Darwin* are friendly rivals. Indeed, those in the know suspect that once the bills start arriving, the two projects will merge. In any case, both will use the same new technique—multiple spacecraft looking at stars from slightly different angles.

At the moment, the obstacle to photographing exoplanets is not the dimness of the planet, but the brightness of the accompanying star, which drowns the planet's light. But by combining images collected by different spacecraft it should be possible to cancel out the star's light—a technique known as nulling interferometry—and thus take pictures of planets the size of Earth.

And not just pictures. By examining the spectrum of an exoplanet, it should be possible to work out if it has an atmosphere and, if so, what that atmosphere consists of. This bears on the question of whether a planet is inhabited (see article). The presence of oxygen, for example, would be a dead (or, rather, live) giveaway. Oxygen is so reactive that its appearance in an atmosphere suggests it is recently made. And any natural chemical process that makes abundant oxygen would almost certainly have to be alive—at least, human chemists know of no exceptions to that rule.

The *TPF* and *Darwin* will both look at relatively nearby stars—within 50-75 light years of Earth. But there are so many stars within that sphere that it is reasonable to expect plenty of planets to turn up. The reason for that expectation is that enough exoplanets have been discovered already for statistically meaningful inferences to be made about what other planets are out there, and where they are. Two facts stand out. Of sun-like stars that have been closely investigated for any length of time, 15% have planets. And within the range of detectable planets, lower-mass bodies are exponentially more common than higher-mass ones. Put these facts together and it seems likely that small, rocky planets might be very common indeed.

Whether alternative Earths, complete with oceans and life, are common is a different question—but it is one that spectroscopy should be able to answer. When the data from the *TPF* and *Darwin* start rolling in, they may provide a definitive answer to that old, nagging question: “is there anybody out there?” How long that answer would take to become commonplace, though, is anybody's guess.

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Methane on Mars

Valuable vapours

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Verily. But verdant?

VITTORIO FORMISANO raised eyebrows in April when he announced, along with several competing groups, that methane had been found on Mars. Dr Formisano is the scientist in charge of the spectrometer (a remote-sensing instrument) on *Mars Express*, a European spacecraft in orbit around that planet. The reason people got excited was that one possible source of methane is bacterial life.

This week, Dr Formisano has beaten his competitors to the punch. At the International Mars Conference in Ischia, Italy, he announced that his analyses showed that the methane is not uniformly distributed in Mars's atmosphere, but is concentrated in three places which are also areas where water vapour is concentrated.

This is particularly noteworthy because *Odyssey*, an earlier (American) probe, had found evidence of ice below the surface at these spots. This suggests that the ice, water vapour and methane are linked. Probably, the link is geological. But everybody hopes that it is biological, with the ice providing the water necessary for methane-generating bacteria to survive.

Beagle 2, a British craft which piggybacked on *Mars Express*, landed right between two of the areas Dr Formisano is interested in, so it might have helped to work out whether there really is methane there. (Other researchers are sceptical about the results, noting that the spectroscopic signatures of methane and water are similar.) Unfortunately, *Beagle*'s fate is a mystery—it disappeared upon landing. So Mars remains momentarily mum on methane.

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Digital bioprospecting

Finding drugs in the library

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Researchers are searching for new medicines lurking in old herbal texts

IT IS a miracle that the “Ambonese Herbal”, a 17th-century medical text compiled by Georg Everhard Rumpf, a German botanist, ever made it to the printing press. Rumphius, as the author styled himself in Latin, was an employee of the Dutch East India Company. He was stationed on Ambon, in the Malay archipelago (now part of Indonesia). He began collecting and drawing plants in 1657, and continued even after going blind in 1670. Four years later he survived an earthquake that killed his wife and daughter, but he then lost all his work in a fire in 1687. Undaunted, Rumphius dictated a new version of his book, the first volume of which was shipped to Europe in 1692, only to be sunk by the French. Fortunately there was a copy, and Rumphius went on to compile six more volumes, completing the last just before his death in 1702. His employers sat on the book for decades, however, fearing that rival nations would benefit from the medical knowledge it contained. Finally, a botanist in Amsterdam published the work between 1741 and 1755.

The “Ambonese Herbal” explains the medical uses of nearly 1,300 species native to the Malay archipelago, based on Rumphius's quizzing of the local population. Medicines shipped from Europe were either useless or unavailable in sufficient quantities, Rumphius complained in the preface, so using local remedies made much more sense. His epic work is just one of many historical texts that contain such “ethnomedical” information.

The medicinal value of plants is still recognised. Roughly half of the anti-cancer drugs developed since the 1960s, and about 100 other drugs on the market, are derived from plants. In the past, figuring out which plants to screen for therapeutic potential involved ethnomedical study in which traditional healers—from village shamans to tale-telling old wives—were asked to identify valuable species. More recently, this approach has given way to high-throughput screening, in which thousands of random specimens are methodically tested by robot technicians.

But both methods have their drawbacks: the knowledge of traditional healers is being lost as they die out, and high-throughput screening has not proved to be very efficient. That is why a team led by Eric Buenz, a researcher at the Mayo Clinic College of Medicine in Rochester, Minnesota, has proposed a new, hybrid approach. Hundreds of unstudied herbal texts, dating from Ancient Greece to the modern age, are sitting in libraries around the world. By sifting through these texts and comparing the results with modern medical databases, it should be possible to identify promising candidate species for further examination and screening. The researchers explain this strategy in a paper published this month in *Trends in Pharmacological Sciences*.

To test their idea, Mr Buenz and his colleagues analysed the first volume of the “Ambonese Herbal”. The text, originally in Dutch and Latin, is in the process of being translated into English. Two reviewers went through the English translation of the first volume and extracted all the medical references. They then drew up a table listing each species, the symptoms for which it was prescribed, and hence its probable pharmacological function. The sap of *Semecarpus cassuvium*, the wild cadju tree, for example, is listed as a treatment for shingles. This suggests that it has antiviral properties.

The list of species was then checked against a database called the International Plant Names Index, to identify misspellings and synonyms. After that, each species was looked up in NAPRALERT, a database listing all known biochemical and ethnomedical references to plants, to see if it had been mentioned in the medical literature. It was thus possible both to determine how accurate the information in the “Ambonese Herbal” is, and to identify candidates for further investigation.

Of the 42 plants described in Rumphius's first volume as having medical properties, 24 had biochemical

matches in NAPRALERT, which suggests that they are indeed effective. Nine of the others had ethnomedical matches, which means their potential use as medicines is already known about, but has not been followed up by modern science. But nine plants did not appear in NAPRALERT at all, and are therefore potential sources of novel drugs.

The next step, says Mr Buenz, is to scale up and automate the process. “Our work with the Rumphius herbal was a proof of concept,” he says. “The push now is to make the project high throughput with bioinformatics.” Book scanners, he observes, have become cheaper and more efficient in recent years. The latest models can scan 1,000 pages an hour, yet are gentle enough to handle old and delicate tomes. And by using natural-language processing software to look for particular expressions, and cross-referencing potential matches with medical and botanical databases, the text can be analysed quickly.

Manually combing through the text of the first volume of the “Ambonese Herbal” took four weeks, says Mr Buenz, but his experimental automated system did the same work in a few hours. The big challenges are dealing with foreign languages, old typefaces and variations in terminology—but translation systems and databases are improving all the time. Text mining will never replace other methods of drug discovery, but tapping the accumulated medical expertise locked up in old documents could, it seems, provide some helpful shortcuts.

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Human evolution

A history of sex

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Evidence that people have been promiscuous for a long time

LOTHARIOS everywhere will be pleased to hear that monogamy does not appear to be a natural human state. That, at least, is the conclusion of a study conducted by Michael Hammer at the University of Arizona in Tucson, and just published in *Nature Genetics*. By examining the DNA of living people, Dr Hammer and his colleagues have found that far fewer men than women pass their genes on to subsequent generations. In short, a small number of men have been putting it about a lot, thus outcompeting their lesser rivals.

The researchers draw their conclusion from differences between the variability of mitochondrial DNA (a type of DNA which follows the female line) and Y-chromosome DNA (which follows the male line). They examined the mitochondrial and Y-chromosome DNA of three widely separated populations—the Khoisan of southern Africa, the Khalks of Mongolia and the highlanders of Papua New Guinea—to see how those DNA sequences differed between the groups. What they found was that there is a lot of variability in the mitochondrial DNA, and much less in the Y-chromosome DNA.

The most plausible explanation for this is that a few men in each generation contribute the bulk of the Y-chromosomes to the next. Indeed, the sums suggest that, over the years, half as many men as women have passed on their genes. This news will not surprise biologists. Although a moment's thought shows the old canard that males are actually, on average, more promiscuous than females cannot be true (since every reproductive act involves one of each) biologists have known for a long time that in most species males *want* to be more promiscuous than females. What holds them back is that females are choosy. And females also tend to be similar in their tastes, which means some males get chosen far more often than others, and therefore have more offspring. Females, by contrast, tend to have about the same number of offspring each.

One result which did surprise the researchers was that men's genes tend to travel farther than women's. Some 70% of the world's modern cultures practice patrilocality—in which a woman moves from her native village to her husband's village when she marries. Until now, it has widely been assumed that this practice would result in women's genes migrating farther afield than men's. So, not only are fewer men than women procreating, but they are travelling farther to sow their oats. Clearly, the tall, dark stranger from another place has been an attractive proposition to women for quite some time.

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George Bush's tax agenda

Handing it back

Sep 23rd 2004
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AP

Radical change that excites Reagan Republicans, but should alarm others

“WE RESOLVE to be the party, not of repose, but of reform. We will write, not footnotes, but chapters in the American story.” Thus, George Bush's pledge at the Republican Party's convention in 2000. Four years later, no one could accuse Mr Bush of sticking to footnotes. The change in America's foreign priorities is profound. At home, Mr Bush has overseen the biggest tax cuts since Ronald Reagan. What is more, if Mr Bush gets re-elected in November, it might begin to look as if his budget revolution has barely begun.

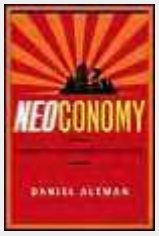
In his speech to the Republican convention this summer, Mr Bush spoke about creating an “ownership society”. He wants, he says, to modernise government programmes, allowing people to switch some of their contributions to Social Security, the federal pensions system, into private, individual accounts. He also talked about reforming America's tax code.

Just what does this add up to? Is Mr Bush planning radical change that will enable America's public finances to cope with the coming retirement of a generation of baby-boomers, or are his plans reckless and unaffordable? Details are scant, or contradictory: for instance, the president proposes both to simplify the tax code and to make the existing tax cuts—which complicate it—permanent. References to costs or priorities are largely absent from Mr Bush's oratory. Fortunately, a number of books help fill the gap.

Conservative Republicans have long championed the privatisation of Social Security and a wholesale reform of America's tax system. They point out that the current system discourages saving, by taxing it twice: once when the initial income is earned, and again when the returns to investment are reaped. At more than 50,000 pages, the tax code's complexity imposes a baneful cost on the economy: a reasonable estimate is over $100 billion a year. Its loopholes encourage people to waste time and money on tax-avoidance schemes.

Over more than two decades, proposals for “fundamental” tax reform have

Neoconomy: George Bush's Revolutionary Gamble With America's Future
By Daniel Altman



PublicAffairs; 290 pages; $26.95

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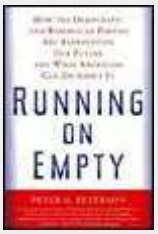
Running on Empty: How the Democratic and Republican Parties are Bankrupting Our Future and What Americans Can Do About It
By Peter G. Peterson

periodically flared up in Washington. Most suggest some variety of a consumption tax, where the burden of taxation falls on consumption rather than on income. In the mid-1990s, after Republicans captured the House of Representatives, debate about tax reform was rife. Top lawmakers talked of pulling the income-tax system out by its roots. Steve Forbes made a flat tax the central plank of his presidential bid in both 1996 and 2000.

For many conservatives, Mr Bush's speech has rekindled the fire. The *Wall Street Journal* admits to being “excited”. Conservative economists and politicians are, once again, touting their favourite version of the consumption tax. Dennis Hastert, speaker of the House of Representatives, says that income taxes should be scrapped in favour of a national sales tax.

Yet those expecting a radical shift from today's tax code to a new system may, once again, be disappointed. High political hurdles exist to fundamental tax reform. Under a consumption tax, the burden of taxation would probably fall more heavily on poorer Americans, since most capital, whose returns would not be taxed, is held by the rich. Once this became clear, political resistance would grow. And any attempt by Mr Bush to eliminate popular tax subsidies, such as the deduction for mortgage interest or the child tax credit, would also provoke an outcry.

Back in 1984, Reagan's Treasury Department looked at replacing the income tax with a consumption tax. It concluded that Americans would think the change unfair. In 2002, Mr Bush's own Treasury prepared a memo on the subject, recently brought into the open by Ron Suskind, the author of a book about Mr Bush's first treasury secretary, Paul O'Neill. The memo says that the economic benefits of fundamental tax reform are uncertain, that major changes increase the risk of “getting it wrong”, and that any reform would have “vocal losers and largely silent winners”. Mr O'Neill claims that the president showed little interest in fundamental tax reform—or, indeed, any understanding of it. This suggests that Mr Bush's call for reform today would be unlikely to involve a wholesale scrapping of the tax code.



Farrar, Straus and Giroux; 272 pages; $24

Buy it at
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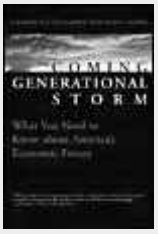
The Coming Generational Storm: What You Need to Know about America's Economic Future
By Laurence J. Kotlikoff and Scott Burns



MIT Press; 328 pages; $27.95 and £18.95

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That does not rule out a fiscal revolution. Look carefully at Mr Bush's tax cuts to date: they suggest a strong desire to reduce the burden of taxation on saving. The estate tax (death duty) is gradually being eliminated; taxes on dividends have been halved (Mr Bush wanted to get rid of them altogether); and proposals for new savings accounts will exempt investment income from tax entirely for nearly all Americans. So, it seems, Mr Bush is trying to reach the goal of a consumption tax not through fundamental tax reform, but simply by a thousand cuts on the taxes on capital.

In his book “Neoconomy”, Daniel Altman, once a journalist with *The Economist* and now with the *New York Times*, points out that this is a revolution by stealth. The strategy does not pull the tax code up by its roots, yet it has profound implications. Supporters tout the potential boost to capital formation, innovation and economic growth. Opponents point out that the tax code will become less progressive, exacerbating income inequality. What is certain is that such reform by stealth carries implications for future tax revenues. According to Mr Altman, almost 20% of taxable income in 2001 came from sources that would no longer be taxed in the “neoconomy”. According to official forecasts, simply making Mr Bush's existing tax cuts permanent doubles the ten-year deficit, to $4.5 trillion.

Sizeable enough, but that sum palls in comparison with America's long-term fiscal problem. The ten-year budget horizon that dominates debate in Washington obscures just how dire is America's fiscal outlook, since it is only just over that horizon that the baby-boomers start to retire in great numbers. Two new books, “Running on Empty”, by a former commerce secretary under Richard Nixon, and “The Coming Generational Storm”, by an economist at Boston University and a financial journalist, paint an altogether starker picture. Both books explain the burden that an ageing population implies. The present value of the gap between America's long-term entitlement promises and its expected tax revenues looks to be more than $70 trillion. Something has got to give.

Both books underline how Mr Bush's tax cuts have made the problem worse. Yet they also make clear that controlling entitlement spending is the real challenge. Here, the president is silent. Though his convention speech talked of diverting payroll taxes to individual accounts, nothing was in it about reducing Social Security benefits. Far from controlling entitlement spending, Mr Bush has expanded it, notably by increasing federal spending on prescription drugs for the old, a measure which, alone, has

increased America's long-term fiscal gap by $17 trillion. Mr Bush's presidential opponent, John Kerry, is no better. He is silent on Social Security reform and offers, if anything, to spend more than Mr Bush on health care.

Just possibly, Mr Bush understands this coming crunch. Just possibly, if he won a second term, he would tackle the tougher parts of tax reform, such as scrapping deductions, and would launch an assault on entitlement spending. However, the evidence of the past four years suggests that, in economic matters, at least, Mr Bush likes the easy if reckless road to revolution.

Neoconomy: George Bush's Revolutionary Gamble With America's Future.
By Daniel Altman.
PublicAffairs; 290 pages; $26.95

Running on Empty: How the Democratic and Republican Parties are Bankrupting Our Future and What Americans Can Do About It.
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The Bush clan

C'mon, Kitty, do the stomp

Sep 23rd 2004
From The Economist print edition

THE world will always have an honourable place for the likes of Kitty Kelley. The celebrity industry has perfected the art of generating puff pieces. Thank heavens that somebody has perfected the art of writing the opposite: works that expose the warts that professional sycophants devote their talents to airbrushing out.

Ms Kelley's book on Jackie Onassis revealed feet of clay inside those haute couture pumps. Her book on Frank Sinatra exposed the misogynistic thug beneath the Rat Pack glamour. One-sided, but no more so than the standard hagiographies.

So it is a shame to report that her latest effort is something of a dud. The Kitty Kelley method works best when she trashes an icon of universal veneration. Yet to at least half of America, the Bushes are not icons, but demons. Forests have been felled to produce anti-Bush polemics. The resources of language have been depleted in denouncing the 43rd president.

It is not clear what Ms Kelley can possibly say that has not already been said. She can tell us that the Bushes have been ruthless in acquiring power and influence. Big deal. She can regale us with stories about young George's appetite for drink and drugs. Nothing new. The most interesting “revelation” in the book—that Mr Bush took cocaine at Camp David while his father was president—does not quite pass the smell test; the witness has already recanted her story. The rest is powder cut pretty thin.

Ms Kelley tries to deal with her central problem—that she doesn't have anything new to tell us about George Bush senior or junior—by focusing on the current president's grandfather: Prescott, the New England banker turned senator who launched the family's political career. Yet her chapters on Prescott are one long yawn. He has been better savaged already by Kevin Phillips. Non-aficionados will wonder what all the fuss is about.

The case against Ms Kelley is not just that she fails to rake new muck. It is that she makes her principal target, the current president, look rather good. Take her account of Mr Bush's Yale years. The Ivy League universities are full of grubbing prodigies who regard themselves as the next president but five. Mr Bush, on the other hand, spent his time doing everything but burnishing his credentials. Ms Kelley relates a story about him “doing the alligator” at a fraternity party—a dance that involves falling to the floor on all fours and rolling around.

Or take her account of a reunion of the Yale class of 1968, hosted by Mr Bush in the White House. One member of the class had had a sex-change operation. Mr Bush was presumably as amazed to see Peter transformed into Petra as Petra was to see the performer of the alligator transformed into the world's most powerful man. Yet Mr Bush did not lose a beat. “Now you've come back as yourself,” he said.

The Family: The Real Story of the Bush Dynasty.
By Kitty Kelley.
Doubleday; 736 pages; $29.95. Bantam Press; £20

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Erotic writing

Brain appeal

Sep 23rd 2004
From The Economist print edition

The acceptable face of pornography

LONDON'S *Erotic Review* set out to achieve the unlikely: pinning a tag of respectability to the downright filthy. From vibrators to Viagra, childhood sexuality to quickies in a hotel room, the review knew no bounds. Only the tedious was censored. The review claimed to appeal to “the primary sexual organ—the brain”, and contributors included A.C. Grayling, a philosopher, and D.B.C. Pierre, a novelist.

Yet things have turned sour for the review. Its circulation has slumped, by nearly half from its peak of 22,000. Last year it was bailed out by publishers of a bestselling lads' magazine. This month the *Erotic Review* was sold again, to Alton Russell, owner of the British version of *Penthouse*, dealing in pure porn, few frills.

The small editorial team was given two days to pack up and leave louche Soho for the suburbs of Surrey. Unwilling to accept that Cobham has its share of sin and swinging, the staff resigned in disgust. Rowan Pelling, the former editor and a Man Booker prize judge, is devastated. “I don't want to be a snob,” she says, “but we were a Soho kind of publication.”

And so the content of the *Erotic Review* is up for grabs. Deric Botham, managing director of Alton Russell, says the review's style will be kept. Former contributors have been begged to write more. The number of issues will rise from ten to 13 a year. To put *Penthouse*'s “values” into the *Erotic Review* would be just “stupid”.

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American Indians

Powwow

Sep 23rd 2004 | WASHINGTON, DC
From The Economist print edition

At last, a national museum of their own

IT WAS, many said, a homecoming. White settlers had driven their ancestors westward, grabbing their lands. Yet on September 21st, more than 10,000 Native Americans came eastward to stake out a space of their own on the National Mall. It was, presumably, the largest number of Indian tribes ever gathered.

It was quite a sight: tribal chiefs in full regalia, and young and old with headdresses, beadwork and porcupine quills. One man carried a bald eagle on his wrist. Tribesmen came from Alaska to the Andes, with “Aztecs” from San Francisco thrown in. Some Latin Americans, in traditional dress that for them is an everyday affair, begged to be photographed with ornate Native Americans, as tourists might do with Beefeaters in London.

The occasion was the opening of the National Museum of the American Indian, the newest addition to the Smithsonian Institution. It has taken 15 years, in part because of a rather painstaking collaboration among 24 Indian tribes across the country. It did not help that Douglas Cardinal, a Blackfoot architect, was kicked off the project in mid-construction.

Rough-hewn and curvilinear, the building is meant to resemble the walls of a canyon. Its integration of elements from nature—from the use of natural light to landscaping around the building—certainly makes it the most intriguing piece of architecture on the Mall. Sadly, the museum's exhibits are less than fulfilling. They show just how hard it is to tell the story of such a varied and far-flung set of peoples.

An anthropological approach is shunned in favour of first-hand accounts by tribal members. The idea is laudable: let the voices of Native Americans—long the objects of ethnological scrutiny—be heard. Yet the result leaves the visitor thirsting for hard information.

The exhibit “Our Peoples”, for example, features “untold” stories from eight tribes: about dispossession, forced removal and the encroachment of modern culture. Still, hard-to-connect imagery—from video footage to real objects—paints an incoherent picture. Another exhibit, “Our Lives”, poses many essential questions, including how to define an Indian. It, too, ends up dancing around the answers. The government's rule-of-thumb—an Indian is one who is at least half-blooded—is too narrow, it is hinted. But then the viewer reads that many tribes use the same racially driven quota. And how on earth to define “blood” in our mongrel world?

Overall, the museum emphasises aesthetics over knowledge. The selection from the permanent collection gives a tiny glimpse of the museum's 800,000 objects. Animal figurines—some 1,000 years old, others only decades—are beautifully displayed together. With descriptions available only on computer, however, the purpose of the objects in the daily lives of Indians is left to the imagination.

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Man Booker prize

Six of the best?

Sep 23rd 2004
From The Economist print edition

The shortlist of novels from which the winner will be chosen on October 19th

Bitter Fruit. By Achmat Dangor. *Atlantic Books; 256 pages; £10.99*
In carefully nuanced detail, a middle-aged Cape Town father re-examines the effect that the rape of his wife by a Boer police officer has on his marriage, his life and his children. A book to read and read again.

Click to buy from Amazon.com or Amazon.co.uk

The Electric Michelangelo. By Sarah Hall. *Faber & Faber; 352 pages; £10.99*
A young orphan from Morecambe Bay opens a tattoo parlour and falls in love with a circus performer, who asks him to cover her entire body with images of eyes. Will the author's imaginative power, deft storytelling and magical prose carry the day?

Click to buy from Amazon.com or Amazon.co.uk

The Line of Beauty. By Alan Hollinghurst. *Picador; 616 pages; £16.99. To be published in America by Bloomsbury in November*
Shy Henry James-loving leech moves into the house of one of Margaret Thatcher's favourite members of parliament and immerses himself in gay sex. It suffers from an all-too-predictable and shallow view of politics, but is still one of the bookies' favourites.

Click to buy from Amazon.com or Amazon.co.uk

Cloud Atlas. By David Mitchell. *Random House; 528 pages; $14.95. Sceptre; £16.99*
Six interlocking stories featuring the voices, among others, of a voyager crossing the Pacific in 1850 and a journalist in Governor Reagan's California. Another punters' favourite. Mr Mitchell's literary pyrotechnics are certainly to be admired, but is his latest effort really anything more than a clever con?

Click to buy from Amazon.com or Amazon.co.uk

The Master. By Colm Toibin. *Scribner*; *352 pages; $25. Picador; £15.99*
A beautifully imagined portrait of Henry James that emphasises his innocence, his shyness and ultimately his human wisdom. One of the strongest contenders for the prize.

Click to buy from Amazon.com or Amazon.co.uk

I'll Go To Bed At Noon. By Gerard Woodward. *Chatto & Windus; 440 pages; £12.99*
A summer idyll turns dark when the Jones family goes on a camping holiday with a tragic end. The best portrayal of drunkenness since Kingsley Amis. Could be this year's dark horse.

Click to buy from Amazon.com or Amazon.co.uk

The Economist's literary editor, Fiammetta Rocco, who is on sabbatical, is one of the five judges that picked this year's Man Booker prize shortlist.

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James Wolfensohn

Dammed if you do

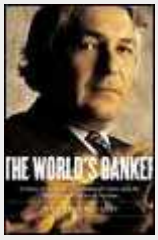
Sep 23rd 2004
From The Economist print edition

BIG dams are horrible things. They flood wide areas, drowning wildlife and displacing thousands of people. That is why the World Bank loves to fund them. Continuing its quest to destroy the planet after which it is named, this sinister organisation decided to lend money to Uganda to erect a concrete monstrosity on the Nile. Ugandan environmentalists were outraged, according to the International Rivers Network (IRN), a pressure group in Berkeley, California. Sebastian Mallaby, a columnist for the *Washington Post* who was at *The Economist* until 1999, went to Uganda to investigate.

He asked the IRN to put him in touch with the Ugandan environmentalists who were so outraged. The IRN refused, for some reason. Undeterred, he tracked down the Ugandan group that the Californians were working with. It had 25 members—"not exactly a broad platform from which to oppose electricity for millions," Mr Mallaby observes. And the people who were to be displaced? The author found them uniformly happy with the compensation offered. The only gripes he heard were from those outside the area that was to be flooded, who were angry that they would not share in the bonanza.

Pressure groups like the IRN spoon-feed lazier journalists than Mr Mallaby. Unelected, unaccountable non-governmental organisations (NGOs) are generally assumed to be honest and virtuous. The World Bank, which does more to fight poverty than any other public body, is generally viewed as the villain. This is partly because it makes mistakes, but mostly because it is besieged by single-issue fanatics in the West who condemn it whenever it fails to make their issue its top priority.

The World's Banker: A Story of Failed States, Financial Crises and the Wealth and Poverty of Nations
By Sebastian Mallaby



The Penguin Press; 400 pages; $29.95. To be published in Britain by Yale University Press in January 2005

Buy it at
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James Wolfensohn, the World Bank's president since 1995, has made strenuous efforts to accommodate the NGO swarm. Every infrastructure project the Bank funds must meet rich-world standards: nothing pretty may be bulldozed unless strictly necessary, and no worker may be asked to do anything that a Californian might find demeaning. As a result, fewer dams, roads and flood barriers are built in poor countries. More poor people stay poor, live in darkness and die younger.

Reuters

Wolfensohn among clients

"The World's Banker" sets out to be a biography of Mr Wolfensohn, but it is really as much about the rich

world's relations with the poor. Mr Mallaby writes about this vast topic with vigour and wit, and in a tone so reasonable it makes you want to slap the people who scale office blocks to unfurl banners proclaiming that the “World Bank Approves China's Genocide in Tibet”. (An absurd claim about the Bank, as Mr Mallaby painstakingly documents, and an unhelpful—to Tibetans—exaggeration of China's policy.)

Another reason why the Bank is unpopular is that it promises too much. An organisation that lends only a few billion dollars a year is hardly in a position to end global poverty. Its greatest value is intellectual: its staff form the brightest concentration of development specialists anywhere. Its research into the slippery question of how poor countries can grow prosperous is always more comprehensive, and sometimes more brilliant, than anything else on offer. When it lends, other lenders heed the signal.

Though not an original thinker, Mr Wolfensohn has generally been on the right side of most of the important debates. He embraced the idea of debt relief while it was still taboo in Washington, and his awesome charm and networking skills helped make it happen. He was also the first World Bank president to acknowledge that corruption in poor countries is not a minor blemish, but one of the main reasons why they remain poor.

His triumphs outnumber his errors, but the errors matter. Trying to placate the Bank's critics seemed a good idea at the time, and he has managed to build constructive relationships with the more grown-up NGOs, such as Oxfam. Yet most pressure groups “do not have an ‘off' switch,” as Mr Mallaby puts it. Nothing the Bank does will ever satisfy them, but by attaching some of the conditions that they demand to its loans, the World Bank makes those loans unattractive, despite their cheapness, to the more creditworthy developing countries, such as Brazil, South Africa and China.

If the Bank were to lose its healthier clients, that would affect its own financial soundness, and therefore its ability to help the poorest. Mr Mallaby writes: “Rather than trying to rebuild the Bank's relationship with all three categories of stakeholder—shareholders, NGOs and borrowers—Wolfensohn should have been more sensitive to the trade-offs between them. And he should have put the borrowers' interests a clear first.”

Mr Wolfensohn comes across as filled with “a roaring restless hunger to do all the things that man can do, and to succeed at all of them.” On the negative side, he is so vain that he prefers to shout at his subordinates than share credit with them. He probably won't like this book. But anyone else who cares about development will.

The World's Banker: A Story of Failed States, Financial Crises and the Wealth and Poverty of Nations. By Sebastian Mallaby.
The Penguin Press; 400 pages; $29.95. To be published in Britain by Yale University Press in January 2005

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Obituary

Johnny Ramone

Sep 23rd 2004
From The Economist print edition

Howard Barlow-RedFerns

Johnny Ramone (John Cummings), a punk rocker, died on September 15th, aged 55

BY THE middle of the 1970s, popular music had changed. The punchy bubblegum sound of the 1960s was gone. Instead the scene was dominated by musicians who wanted to elevate rock to the status of high art, with concept albums, rock operas and overblown guitar solos. A typical track from the Sixties might be four minutes long; by the mid-1970s, ten minutes or more was not unusual. Many fans despaired, feeling that rock had become bloated, pompous and pretentious.

The counterblast began on August 16th 1974, in front of a tiny crowd in a seedy New York bar called CBGB. Four young men—Johnny, Joey, Dee Dee and Tommy Ramone—walked on stage. The concert they gave was shambolic; they spent as much time shouting at each other as playing. But they improved rapidly, and it soon became clear they had hit on something.

Dressed in ripped jeans, trainers and leather jackets (a uniform carefully modelled on the gear worn by New York rent-boys), the Ramones were the antithesis of the art-house pretension in which much of rock had lost itself. Their formula was simple: no synthesisers, chamber orchestras or tedious showing off, just simple three-chord progressions wrapped in two-minute slices of buzzing guitar. They belted out catchy, rapid-fire songs on the usual topics: teenage boredom, mental instability, drugs and disappointed love. Their message was a liberating one: you didn't have to be a virtuoso to make music. Anybody could do it, and technical skill was less important than having a good time and putting on a show for your fans.

Their bare-bones playing was matched by their singing. The lyrics to “I Don't Wanna Walk Around With You” were four lines long, of which three were the same. Their songs were never allowed to venture too far into seriousness. “Beat on the brat with a baseball bat, oh yeah,” they sang cheerfully on their debut album.

This back-to-basics approach never translated into commercial success. The Ramones built up a cult following on both sides of the Atlantic, but their impact was felt more keenly in Britain than in America. Their concert at London's Roundhouse theatre in 1976 was a seminal moment for British punk. The British movement was different: more intense, angrier, more worldly. But the snarlingly political Clash, the anarchic Sex Pistols and the hundreds of smaller, amateur bands that gave voice to the alienation felt by many of the young all had their roots in the do-it-yourself attitude pioneered by the Ramones.

Even among a band destined to remain one of music's great outsiders, Johnny Ramone was an oddity. His father was a strict disciplinarian, and the attitude rubbed off. Johnny, who had a fondness for

American army T-shirts, liked to compare himself to a hard-working carpenter. The hammer and chisel were the tools of the carpenter's trade; the guitar was the tool of his. Rock concerts are usually referred to as “gigs”, but Johnny liked to call them “jobs”.

In concert he would stride out on stage, plant his feet wide apart and begin playing in his distinctive style (using only the downstroke, never the up), blowing through songs at breakneck speed. He kept a meticulous diary on every aspect of the band, from the price of their equipment to notes on every one of their concerts. Over two decades, he played 2,263 of them.

Conservative tastes

His political views were wildly out of step. Almost uniquely in the rock-music industry, he was a staunch conservative. He idolised Ronald Reagan, and used the band's induction into the Rock 'n' Roll Hall of Fame in 2002 to heap praise on George Bush. There were rumours of a nastier side. When a black man stepped in front of their tour van, he told the driver: “Run him over, Monte. It's just one less nigger.” He explained that being deliberately offensive was part of his sense of humour. Others were less sure. It was said that he carried a Ku Klux Klan card in his wallet.

But Johnny's role as the band's “drill sergeant” was crucial. His frantic guitar-playing set the pace for the others to match. He was responsible for the uniform, and also for the group's longevity. One of his favourite dictums was that when bands changed, it was usually for the worse. He kept the Ramones anchored to his original vision while other acts climbed the charts, went mainstream and then disintegrated in recrimination and accusations of selling-out. In the late 1970s, the band survived a collaboration with Phil Spector; it endured even after Johnny stole singer Joey's girlfriend, a testament to their professionalism and discipline in an industry known for neither.

After their last concert in 1996, the Ramones' reputation grew. They had a heavy influence on the grunge groups of the early 1990s, and at last earned mainstream recognition in America. They are remembered as the band that saved rock from its own excesses and returned it to its roots as an outlet for the young and disaffected.

When Joe Strummer, the lead singer of the Clash, approached the Ramones after seeing them play in 1976, he was worried that his band's musicianship was still too rough for them to begin performing. “Are you kidding?” Johnny answered him. “We're lousy, we can't play. If you wait until you can play, you'll be too old to get up there. We stink, really. But it's great.”

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Overview

Sep 23rd 2004
From The Economist print edition

The **oil price** rose sharply to over $48 a barrel for American crude, close to the peak reached in August. The jump occurred after the American government revealed a big fall in oil stocks. Oil production in the Gulf of Mexico has been disrupted as a result of hurricane Ivan.

America's central bank raised its target for the federal-funds interest rate from 1.5% to 1.75%. The Federal Reserve's decision to tighten monetary policy again came despite an easing in immediate inflationary pressures. Consumer prices rose by just 0.1% in August. The annual rate of consumer-price inflation fell to 2.7% from 3.0% in July.

Housing starts in **America** rose to an annual rate of 2m in August, the most since March and 9% higher than a year ago. However, consumer confidence remained virtually unchanged in September according to the University of Michigan's index.

In **Canada**, consumer prices eased unexpectedly by 0.2% in August. The annual rate of inflation fell to 1.9%, down from 2.3% in the year to July.

Industrial output in the **euro area** grew by 2.4% in the year to July. But new industrial orders were 0.6% lower in July than in June. The euro area chalked up a trade surplus of €12.6 billion ($15.6 billion) in July.

In **Britain**, the Bank of England's committee responsible for setting interest rates appears to have become gloomier about the economy's prospects, according to minutes of its meeting earlier this month when it left the key rate unchanged at 4.75%.

Household spending on manufactured goods in **France** has yo-yoed over the summer. First, it increased by 3.1% in June; then it declined by 2.9% in July; it has subsequently risen by 0.5% in August. Despite this monthly volatility, it is 5.4% higher than a year ago.

Italy's consumers are perking up. The ISAE consumer-confidence index rose in September to its highest level since the end of last year. This was the fourth consecutive month in which confidence has revived.

In **Switzerland**, industrial production increased by 4.3% in the year to the second quarter.

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Output, demand and jobs

Sep 23rd 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 4.1	Q2	+ 2.5	+ 3.6	+ 3.3	– 1.1	Q1	+ 7.9	Q2	5.7	Aug	6.2
Austria	+ 0.5	Q1	+ 0.8	+ 1.6	+ 2.1	+ 4.3	Jun	+ 5.8	Jun	4.2	Jul	4.5
Belgium	+ 2.7	Q2	+ 3.0	+ 2.4	+ 2.1	+ 1.5	Jul	+ 4.4	Jun	13.2	Aug†	13.3
Britain	+ 3.7	Q2	+ 3.8	+ 3.4	+ 2.7	+ 0.1	Jul	+ 6.5	Aug	4.7	Jul††	5.1
Canada	+ 3.0	Q2	+ 4.3	+ 3.0	+ 3.4	+ 5.0	Jun	+ 3.1	Jun	7.2	Aug	8.0
Denmark	+ 2.5	Q2	+ 0.9	+ 2.1	+ 2.3	+ 0.7	Jul	+ 4.9	Jul	6.2	Jul	6.0
France	+ 3.0	Q2	+ 3.4	+ 2.4	+ 2.2	+ 2.5	Jul	+ 2.1	Jul	9.8	Jul	9.8
Germany	+ 2.0	Q2	+ 1.9	+ 1.5	+ 1.7	+ 2.2	Jul	nil	Jul	10.6	Aug§	10.6
Italy	+ 1.2	Q2	+ 1.1	+ 1.2	+ 1.7	– 1.2	Jul	– 0.8	Jun	8.5	Apr	8.7
Japan	+ 4.2	Q2	+ 1.3	+ 4.5	+ 2.3	+ 5.9	Jul	+ 0.8	Jul	4.9	Jul	5.3
Netherlands	+ 1.0	Q2	– 0.8	+ 1.3	+ 1.7	+ 0.2	Jul	– 0.7	Jun‡	6.2	Aug**	5.3
Spain	+ 2.6	Q2	+ 2.0	+ 2.8	+ 2.8	+ 0.4	Jul	+ 3.0	Jul	11.0	Jul	11.3
Sweden	+ 3.4	Q2	+ 3.8	+ 3.0	+ 2.7	– 0.1	Jul	+ 3.2	Jul	5.5	Aug†	5.4
Switzerland	+ 2.0	Q2	+ 1.6	+ 1.9	+ 2.0	+ 4.3	Q2	– 0.8	Jul	3.7	Aug†	3.6
United States	+ 4.7	Q2	+ 2.8	+ 4.3	+ 3.4	+ 5.2	Aug	+ 5.5	Jul	5.4	Aug	6.1
Euro area	+ 2.0	Q2	+ 2.1	+ 1.8	+ 2.0	+ 2.4	Jul	+ 1.1	Jul	9.0	Jul	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.7	Q2	+ 2.9	na	na	+ 7.8	Jul	+ 5.1	Jul	8.0	Aug†	7.7
Greece	+ 3.9	Q2	– 0.6	na	na	– 0.6	Jul	+ 5.5	Jun	na		na
Iceland	+ 6.2	Q2	na	na	na	na		na		3.0	Jul†	3.0
Ireland	+ 6.1	Q1	na	na	na	+ 4.2	Jun	+ 1.2	Jul	4.3	Aug	4.7
Luxembourg	+ 2.1	2003	na	na	na	– 1.2	Dec	+ 3.4	Apr	4.0	Jul	3.6
New Zealand	+ 5.0	Q1	+ 9.6	na	na	+ 5.5	Q1	+ 6.8	Q2	4.0	Q2	4.7
Norway	+ 4.1	Q2	+ 5.0	na	na	+ 3.5	Jul	+ 2.0	Jul	4.6	Q2	4.7
Portugal	+ 1.5	Q2	+ 4.7	na	na	– 3.4	Jul	+ 2.8	Jul	6.3	Q2†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††May-Jul; claimant count rate 2.7% in Aug. §EU harmonised rate 9.9% in Jul. **Jun-Aug.

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Prices and wages

Sep 23rd 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.5	Q2	+ 2.7	+ 2.4	+ 2.6	+ 2.8	Q2	+ 0.2	+ 2.9	Q2	+ 5.5
Austria	+ 2.4	Aug	+ 1.2	+ 1.6	+ 1.5	+ 6.3	Aug	+ 1.3	+ 1.9	Jul	+ 2.3
Belgium	+ 2.3	Aug	+ 1.8	+ 1.9	+ 1.6	+ 5.8	Aug	– 1.4	+ 2.2	Jul	+ 1.9
Britain	+ 1.3	Aug*	+ 1.4	+ 1.5	+ 1.8	+ 2.6	Aug	+ 1.5	+ 3.8	Jul†	+ 3.3
Canada	+ 1.9	Aug	+ 2.0	+ 2.0	+ 2.2	+ 5.0	Jul	– 1.6	+ 3.2	Jun	+ 3.8
Denmark	+ 1.2	Aug	+ 1.7	+ 1.2	+ 1.8	+ 3.1	Aug	– 0.3	+ 3.1	Q2	+ 3.8
France	+ 2.4	Aug	+ 1.9	+ 2.2	+ 1.6	+ 2.2	Jun	+ 0.9	+ 2.8	Q1	+ 2.9
Germany	+ 2.0	Aug	+ 1.1	+ 1.7	+ 1.3	+ 4.2	Aug	+ 0.5	+ 1.4	Jun	+ 2.0
Italy	+ 2.3	Aug	+ 2.8	+ 2.3	+ 2.1	+ 3.3	Jul	+ 1.3	+ 2.6	Aug	+ 2.6
Japan	– 0.1	Jul	– 0.2	– 0.1	+ 0.2	+ 1.7	Aug	– 0.7	+ 2.0	Jul	+ 3.6
Netherlands	+ 1.1	Aug	+ 2.1	+ 1.4	+ 1.4	+ 4.9	Jul	+ 0.2	+ 1.2	Aug	+ 2.5
Spain	+ 3.3	Aug	+ 3.0	+ 2.9	+ 2.7	+ 4.1	Jul	+ 1.1	+ 3.1	Q2	+ 4.2
Sweden	+ 0.6	Aug	+ 1.7	+ 0.8	+ 1.5	+ 1.9	Jul	– 1.5	+ 1.1	Jun	+ 3.5
Switzerland	+ 1.0	Aug	+ 0.5	+ 0.7	+ 1.1	+ 1.5	Aug	– 0.3	+ 1.4	2003	+ 1.8
United States	+ 2.7	Aug	+ 2.2	+ 2.7	+ 2.4	+ 3.4	Aug	+ 3.5	+ 2.3	Aug	+ 2.6
Euro area	+ 2.3	Aug	+ 2.1	+ 2.1	+ 1.7	+ 2.8	Jul	+ 1.1	+ 2.2	Q2	+ 3.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.4	Aug	+ 0.6	na	na	+ 1.8	Aug	+ 0.3	+ 3.5	Q2	+ 4.4
Greece	+ 2.7	Aug	+ 3.3	na	na	+ 2.3	Jul	+ 2.9	na		na
Iceland	+ 3.4	Sep	+ 2.2	na	na	+ 7.2	Sep	+ 3.6	+ 5.2	Aug	+ 5.7
Ireland	+ 2.6	Aug	+ 3.2	na	na	– 0.7	Jul	– 8.2	+ 3.8	Q2	+ 8.0
Luxembourg	+ 2.3	Aug	+ 2.0	na	na	+ 9.6	Jul	+ 0.7	– 0.4	Dec	+ 0.7
New Zealand	+ 2.4	Q2	+ 1.5	na	na	+ 1.5	Q2	– 1.9	+ 2.3	Q2	+ 2.3
Norway	+ 1.0	Aug	+ 2.1	na	na	+16.4	Aug	+ 6.1	+ 4.5	Q2	+ 5.4
Portugal	+ 2.3	Aug	+ 2.8	na	na	+ 4.1	Aug	+ 0.1	+ 1.4	Jul	– 2.5

*New series. RPI inflation rate in August: 3.2%.

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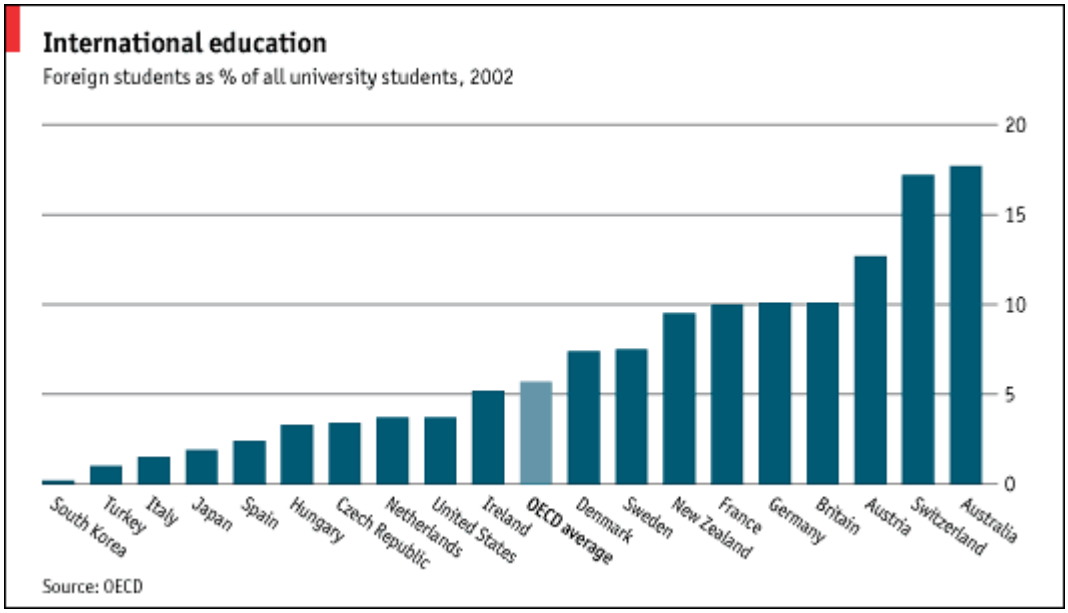
International education

Sep 23rd 2004
From The Economist print edition



More and more students are studying abroad. Foreign students are most prominent in Australian and Swiss universities, where they represent over 17% of all students. By contrast, they make up only 4% of America's students. However, the sheer scale of university education in America means that it attracts 30% of the foreign-student population. English is a lure. Half of foreign students choose America, Britain and Australia.

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Money and interest rates

Sep 23rd 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Sep 22nd 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 5.5	+12.0	Jul	5.40	4.92	5.03	5.37	5.47	6.12
Britain	+ 5.1	+ 9.7	Aug	4.91	3.66	4.71	4.82	4.60	5.57
Canada	+10.8	+ 7.4	Jul	2.46	2.59	3.05	4.54	4.64	6.11
Denmark	+ 8.4	+10.3	Jul	2.25	2.30	2.77	4.05	4.27	5.38
Japan	+ 3.8	+ 1.9	Aug	0.02	0.01	0.13	1.48	1.28	1.56
Sweden	+ 1.5	+ 2.3	Jul	1.98	2.69	2.80	4.27	4.58	2.86
Switzerland	+ 0.6	+ 2.0	Aug	0.66	0.24	1.14	2.62	2.69	2.37
United States	+ 4.7	+ 4.4	Aug	1.78	1.04	2.47	3.99	4.13	5.63
Euro area†	+10.1	+ 5.5	Jul	2.12	2.14	2.55	3.94	4.07	3.78

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.77%, Japan No. 263 1.47%. Central bank rates: US fed funds 1.75%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Sep 23rd 2004
From The Economist print edition

1995=100

	Sep 7th*	Sep 14th	Sep 21st†	% change on one month	% change on one year
Dollar index					
All items	88.2	87.8	87.9	– 2.9	+ 8.5
Food	81.7	81.0	80.7	– 4.6	nil
Industrials					
All	96.9	97.0	97.6	– 0.9	+19.6
Nfa‡	93.2	90.7	86.0	– 7.1	– 0.9
Metals	100.2	102.3	107.5	+ 3.7	+39.1
Sterling index					
All items	78.5	76.9	77.3	– 2.8	nil
Euro index					
All items	96.0	94.0	94.3	– 4.0	+ 1.2
Yen index					
All items	102.6	102.4	102.0	– 3.3	+ 6.0
Gold					
$ per oz	399.00	406.13	408.53	+ 0.8	+ 6.0
West Texas Intermediate					
$ per barrel	43.23	44.40	46.93	+ 3.8	+73.0

* Revised. † Provisional. ‡ Non-food agriculturals.

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Stockmarkets

Sep 23rd 2004
From The Economist print edition

Market indices

	Sep 22nd	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,652.6	3,652.6	3,274.9	+ 0.4	nil	+10.5	+ 3.6
Austria (ATX)	2,038.7	2,048.2	1,568.9	+ 2.8	- 0.5	+31.9	+28.0
Belgium (Bel 20)	2,665.6	2,678.3	2,244.2	+ 0.4	-27.6	+18.8	+15.2
Britain (FTSE 100)	4,592.3	4,608.4	4,287.0	+ 1.0	-33.7	+ 2.6	+ 2.7
Canada (Toronto Composite)	8,586.1	8,898.8	8,123.5	+ 1.4	-24.6	+ 4.4	+ 5.2
Denmark (KBX)	245.7	246.5	219.0	+ 0.9	-18.6	+15.0	+11.7
France (SBF 250)	2,520.6	2,594.4	2,386.1	- 0.1	-42.6	+ 4.5	+ 1.4
(CAC 40)	3,692.1	3,811.4	3,465.3	nil	-46.7	+ 3.8	+ 0.7
Germany (DAX)	3,942.4	4,151.8	3,647.0	nil	-51.1	- 0.6	- 3.5
Italy (BCI)	1,326.9	1,340.3	1,239.5	+ 0.9	-39.2	+ 5.6	+ 2.5
Japan (Nikkei 225)	11,019.4	12,163.9	10,365.4	- 1.2	-71.7	+ 3.2	nil
(Topix)	1,114.1	1,217.9	1,022.6	- 1.3	-61.4	+ 6.7	+ 3.4
Netherlands (AEX)	329.5	364.8	310.7	- 0.8	-53.0	- 2.4	- 5.3
Spain (Madrid SE)	849.3	881.7	804.4	- 0.4	-25.9	+ 5.1	+ 2.0
Sweden (Affarsvarlden Gen)	206.4	218.1	188.5	+ 1.2	-48.4	+ 9.6	+ 6.6
Switzerland (Swiss Market)	5,572.6	5,934.4	5,309.8	+ 0.7	-33.8	+ 1.5	- 0.6
United States (DJIA)	10,109.2	10,737.7	9,814.6	- 1.2	-13.8	- 3.3	- 3.3
(S&P 500)	1,113.6	1,157.8	1,063.2	- 0.6	-27.1	+ 0.1	+ 0.1
(NASDAQ Comp)	1,885.7	2,153.8	1,752.5	- 0.6	-62.6	- 5.9	- 5.9
Europe (FTSE Eurotop 300)*	996.7	1,026.2	940.9	+ 0.5	-41.5	+ 4.0	+ 1.0
Euro area (FTSE Ebloc 100)*	840.5	888.3	787.2	nil	-45.8	+ 1.1	- 1.9
World (MSCI)†	1,045.3	1,085.8	997.0	+ 0.1	-27.9	+ 0.9	+ 0.9
World bond market (Citigroup)‡	609.4	619.5	575.1	+ 0.8	- 1.6	+ 0.9	+ 0.9

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Sep 23rd 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		Current account The Economist poll % of GDP, forecast 2004	Current account The Economist poll % of GDP, forecast 2005	Exchange rate trade-weighted† 1990=100 Sep 22nd	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Sep 22nd	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2004‡
Australia	− 16.8	Jul	− 34.2	Q2	− 5.6	− 4.9	83.7	83.1	1.42	1.48	2.54	1.73	1.28	0.5
Austria	− 1.5	Jul	− 1.9	Jul	− 0.4	− 0.5	103.0§	103.0	0.82	0.87	1.46	–	0.74	-1.3
Belgium	+ 20.3	Jul	+ 12.2	Mar	+ 3.2	+ 3.5	103.1§	103.0	0.82	0.87	1.46	–	0.74	-0.2
Britain	− 97.5	Jul	− 39.2	Q1	− 2.3	− 2.3	103.2	100.2	0.56	0.60	–	0.68	0.50	-2.9
Canada	+ 49.3	Jul	+ 23.8	Q2	+ 2.4	+ 2.1	90.0	86.9	1.28	1.36	2.30	1.57	1.16	1.2
Denmark	+ 10.4	Jul	+ 7.0	Jul	+ 2.7	+ 2.6	106.5	105.7	6.08	6.48	10.9	7.44	5.49	0.9
France	+ 3.7	Jun††	− 0.7	Jul	+ 0.5	+ 0.6	106.5§	106.4	0.82	0.87	1.46	–	0.74	-3.8
Germany	+186.4	Jul	+ 95.1	Jul	+ 2.8	+ 2.8	104.3§	104.1	0.82	0.87	1.46	–	0.74	-3.7
Italy	+ 2.5	Jun	− 14.5	Jun	− 1.0	− 1.0	76.0§	75.9	0.82	0.87	1.46	–	0.74	-3.1
Japan	+133.4	Jul	+165.8	Jul	+ 3.5	+ 3.6	132.9	135.5	111	112	198	135	–	-7.1
Netherlands	+ 33.7	Jul	+ 20.7	Q2	+ 2.7	+ 2.9	102.6§	102.5	0.82	0.87	1.46	–	0.74	-3.1
Spain	− 62.4	Jun	− 30.0	May	− 2.8	− 2.9	77.1§	77.1	0.82	0.87	1.46	–	0.74	0.3
Sweden	+ 22.7	Jul	+ 23.4	Q2	+ 6.3	+ 6.1	82.2	82.7	7.40	7.76	13.3	9.05	6.69	0.2
Switzerland	+ 8.2	Aug	+ 37.5	Q1	+10.9	+10.6	112.4	110.8	1.26	1.36	2.26	1.55	1.14	-1.6
United States	−598.3	Jul	−571.9	Q2	− 5.1	− 5.0	96.3	100.9	–	–	1.79	1.22	0.90	-4.7
Euro area	+111.8	Jul	+ 59.7	Jun	+ 0.5	+ 0.5	91.1	89.1	0.82	0.87	1.46	–	0.74	-2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.8	Jul	+ 11.2	Jul	na	na	82.2§	82.0	0.82	0.87	1.47	–	0.74	1.6
Greece	− 28.1	Jun	− 11.1	Jul	na	na	59.6§	59.6	0.82	0.87	1.47	–	0.74	-3.2
Iceland	− 0.4	Jul	− 0.6	Q2	na	na	95.2**	99.1	71.5	77.2	128	87.5	64.6	0.2
Ireland	+ 41.8	Jun	− 2.1	Q1	na	na	94.2§	94.7	0.82	0.87	1.47	–	0.74	-0.5
Luxembourg	− 3.9	Jun	+ 3.2	Q1	na	na	103.1§	103.0	0.82	0.87	1.47	–	0.74	-1.8
New Zealand	− 2.1	Jul	− 3.4	Q1	na	na	106.1	98.4	1.51	1.68	2.71	1.85	1.36	2.9
Norway	+ 30.2	Aug	+ 30.1	Jun	na	na	96.1	99.0	6.84	7.02	12.3	8.37	6.18	10.4
Portugal	− 16.9	Jun	− 10.0	Jul	na	na	93.6**	93.8	0.82	0.87	1.47	–	0.74	-3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, July average. ‡OECD forecast. **IMF, May average. ††New series

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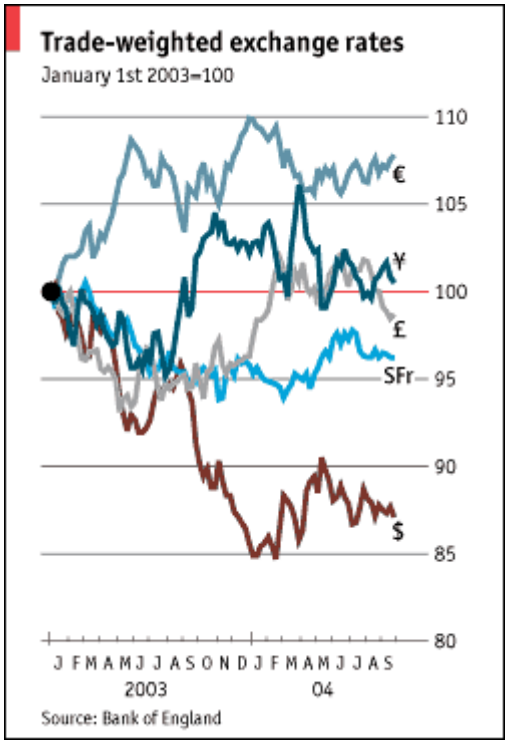
Trade-weighted exchange rates

Sep 23rd 2004
From The Economist print edition



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Overview

Sep 23rd 2004
From The Economist print edition

Argentina's economy continues to recover strongly, although the pace is slowing. Helped by agricultural exports and investment, GDP grew by 7.0% in the year to the second quarter. National output also rose in **Peru**, by 3.8% in the year to July.

Industrial production in **Poland** surged by 13.5% in the 12 months to August. In **Hong Kong**, growth in industrial output slackened to 1.1% in the year to the second quarter.

South Africa's current-account deficit grew to $3.5 billion in the year to the second quarter. **Brazil's** current-account surplus in the 12 months to August rose to $9.7 billion.Statistics on 25 emerging economies, plus a closer look at foreign direct investment.

Singapore's trade surplus picked up to $16.0 billion in the 12 months to August.

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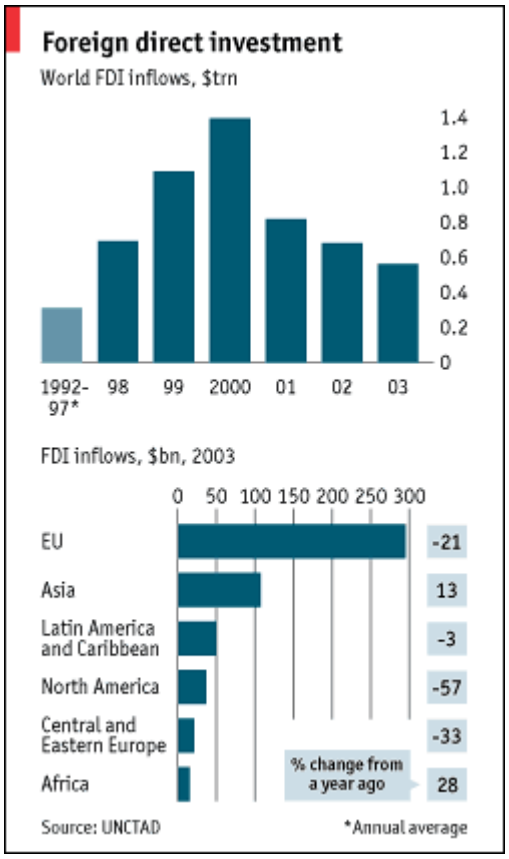
Foreign direct investment

Sep 23rd 2004
From The Economist print edition

Foreign direct investment—the purchase of factories and other fixed assets by companies—has been an engine of globalisation. But FDI has now declined for the third year running. According to UNCTAD, it fell by 18% to $560 billion in 2003, less than half the peak reached in 2000. Inward investment into the developed world fell. Into the United States it slumped by 53% to the lowest level since 1992. However FDI into the developing world rose by 9%. This overall increase masked divergent regional trends. Inward investment into Latin America and Eastern Europe fell, but this was more than offset by a 13% increase of FDI into Asia.



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Economy

Sep 23rd 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn		Foreign reserves* $bn, latest
	GDP		Industrial production		Consumer prices		Trade balance	Current account	
China	+ 9.6	Q2	+15.9	Aug	+ 5.3	Aug	+16.2 Aug	+45.9 2003	483.0 Jul
Hong Kong	+12.1	Q2	+ 1.1	Q2	+ 0.9	Jul	−13.4 Jul	+14.8 Q1	118.5 Aug
India	+ 8.2	Q1	+ 7.9	Jul	+ 3.2	Jul	−18.5 Aug	+ 8.7 Q1	112.1 Aug
Indonesia	+ 4.3	Q2	+15.0	Jun	+ 6.7	Aug	+24.8 Jul	+ 3.9 Q2	33.6 Jul
Malaysia	+ 8.0	Q2	+ 9.9	Jul	+ 1.4	Aug	+20.1 Jul	+13.0 Q1	54.5 Aug
Philippines	+ 6.2	Q2	+ 2.7	Jun	+ 6.3	Aug	− 1.6 Jul	+ 3.9 Mar	12.7 Aug
Singapore	+12.5	Q2	+19.0	Jul	+ 1.6	Aug	+16.0 Aug	+28.4 Q2	101.3 Aug
South Korea	+ 5.5	Q2	+12.8	Jul	+ 4.8	Aug	+29.2 Aug	+27.5 Jul	170.4 Aug
Taiwan	+ 7.7	Q2	+ 9.5	Jul	+ 2.5	Aug	+11.6 Aug	+25.8 Q2	231.6 Aug
Thailand	+ 6.3	Q2	+ 9.3	Jul	+ 3.1	Aug	+ 1.8 Jul	+ 7.2 Jul	42.4 Jul
Argentina	+ 7.0	Q2	+ 8.3	Jul	+ 5.2	Aug	+12.8 Jul	+ 6.1 Q1	18.1 Aug
Brazil	+ 5.7	Q2	+ 9.6	Jul	+ 7.2	Aug	+31.7 Aug	+ 9.7 Aug	49.7 Jul
Chile	+ 5.1	Q2	+ 5.8	Jul	+ 1.6	Aug	+ 7.4 Aug	+ 1.2 Q2	15.8 Aug
Colombia	+ 4.3	Q2	+11.7	Jun	+ 5.9	Aug	+ 0.1 Jun	− 1.6 Q1	12.0 Aug
Mexico	+ 3.9	Q2	+ 3.8	Jul	+ 4.8	Aug	− 5.7 Jul	− 6.7 Q2	60.3 Jul
Peru	+ 3.8	Jul	+ 8.4	Jul	+ 4.6	Aug	+ 1.8 Jul	− 0.7 Q2	10.2 Aug
Venezuela	+13.6	Q2	+32.2	Jun	+21.9	Aug	+20.3 Q2	+14.0 Q2	18.0 Jun
Egypt	+ 4.3	2004†	+ 2.6	2003†	+16.5	May‡	− 7.5 Q2	+ 3.7 Q2	13.3 May
Israel	+ 3.0	Q2	+11.0	Jun	+ 0.5	Aug	− 6.2 Aug	+ 0.1 Q2	26.1 Aug
South Africa	+ 2.5	Q2	+ 5.5	Jul	+ 1.6	Jul	− 0.2 Jul	− 3.5 Q2	10.4 Aug
Turkey	+13.4	Q2	+12.8	Jul	+10.0	Aug	−31.2 Aug	−11.6 Jul	32.4 Jul
Czech Republic	+ 4.1	Q2	+11.0	Jul	+ 3.4	Aug	− 2.1 Jul	− 6.2 Q2	26.3 Aug
Hungary	+ 4.0	Q2	+ 7.6	Jul	+ 7.2	Aug	− 3.6 Apr	− 8.4 Apr	12.8 Aug
Poland	+ 6.1	Q2	+13.5	Aug	+ 4.6	Aug	− 5.3 Jul	− 4.0 Jul	34.6 Jul
Russia	+ 7.4	Q2	+ 6.8	Aug	+11.3	Aug	+69.5 Jul	+38.4 Q2	84.9 Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	+ 6.0	Q2	+ 6.0	Aug	+ 4.0	Aug	− 2.5 Jun	− 1.5 Q2	1.4 Jul
Latvia	+ 7.7	Q2	+ 7.8	Jul	+ 7.8	Aug	− 2.5 Jul	− 1.4 Jul	1.6 Jul
Lithuania	+ 6.9	Q2	na		+ 2.2	Aug	− 3.1 Jul	− 1.5 Q1	3.3 Jul
Slovakia	+ 5.4	Q2	+ 0.7	Jul	+ 7.2	Aug	− 0.7 Jul	− 0.4 May	12.8 Jul
Slovenia	+ 4.6	Q2	+ 3.0	Jul	+ 3.7	Aug	− 0.9 Jul	− 0.1 Jul	7.9 Jun
Pakistan	+ 6.4	2004†	+24.8	May	+ 9.2	Aug	− 3.7 Aug	+ 1.8 Q2	11.2 Jun
Saudi Arabia	+ 7.2	2003	na		+ 0.2	Jun	+61.2 2003	+29.7 2003	22.2 Aug

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series, % change Jan-May annualised.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Sep 23rd 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Sep 22nd		Dec 31st 2003	
	Sep 22nd	year ago	Sep 22nd	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	14.8	3.70	1,489.9	+4.8	– 5.1	– 5.0
Hong Kong	7.80	7.80	14.0	1.11	13,272.2	+1.4	+ 5.5	+ 5.0
India	45.8	45.7	82.1	4.65	5,616.9	+3.6	– 3.8	– 4.2
Indonesia	9,163	8,425	16,424	7.50	818.2	+0.3	+ 18.3	+ 8.7
Malaysia	3.80	3.80	6.81	2.87	856.3	+0.4	+ 7.9	+ 7.9
Philippines	56.4	54.9	101.0	7.50	1,727.9	+1.3	+ 19.8	+ 18.0
Singapore	1.69	1.75	3.04	1.44	1,993.6	–0.5	+ 13.0	+ 13.3
South Korea	1,148	1,170	2,057	3.53	835.1	–1.8	+ 3.0	+ 7.0
Taiwan	33.8	34.1	60.5	1.20	5,970.2	+1.7	+ 1.3	+ 1.9
Thailand	41.4	40.4	74.2	1.80	663.5	+0.2	– 14.1	– 17.7
Argentina	3.00	2.95	5.38	5.44	1,085.8	+5.8	+ 1.3	– 1.1
Brazil	2.87	2.91	5.14	16.24	22,748.0	+1.8	+ 2.3	+ 2.8
Chile	613	681	1,099	1.92	8,388.5	+1.3	+ 14.3	+ 10.5
Colombia	2,560	2,823	4,589	7.72	3,626.6	+1.1	+ 55.4	+ 68.7
Mexico	11.4	10.9	20.4	7.31	10,777.2	+1.1	+ 22.5	+ 20.8
Peru	3.35	3.48	6.01	2.73	3,035.5	+1.0	+ 24.7	+ 28.8
Venezuela	2,536§	1,598	4,545	13.53	29,181.5	–5.4	+ 31.4	+ 47.8
Egypt	6.23	6.15	11.16	10.71	19,903.7	–0.3	+ 71.0	+ 69.4
Israel	4.49	4.48	8.04	1.00	567.9	+0.4	+ 6.3	+ 4.1
South Africa	6.51	7.38	11.7	7.45	11,559.8	+3.0	+ 11.3	+ 14.1
Turkey	1,510,500	1,387,500	2,707,420	24.15	21,491.4	–0.6	+ 15.4	+ 7.3
Czech Republic	25.7	29.3	46.1	2.77	860.2	+0.4	+ 30.5	+ 30.3
Hungary	201	229	360	10.95	12,306.1	+2.9	+ 31.2	+ 35.5
Poland	3.54	3.97	6.34	6.95	25,199.8	+0.1	+ 21.0	+ 28.1
Russia	29.2	30.6	52.4	13.00	624.6‡	+2.1	+ 10.0	+ 10.1
EMF (MSCI)*	1.00	1.00	1.79	na	462.7	+1.5	+ 4.5	+ 4.5
EMBI+†	1.00	1.00	1.79	na	315.9	+1.4	+ 7.1	+ 7.1

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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